

POTLATCH CORP (OLD)

FORM 10-K (Annual Report)

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934**

For the Fiscal Year Ended
December 31, 2004

Commission File
Number 1-5313



Potlatch Corporation

A Delaware Corporation

(IRS Employer Identification
Number 82-0156045)

601 West Riverside Ave., Suite 1100
Spokane, Washington 99201
Telephone (509) 835-1500

Securities registered pursuant to Section 12(b) of the Act:

Title of each class

**Name of each exchange
on which registered**

Common Stock
(\$1 par value)

New York Stock Exchange
Pacific Exchange
Chicago Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

Title of each class

None

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes ☒ No ☐

The aggregate market value of the voting stock held by non-affiliates of the registrant at June 30, 2004, was approximately \$1,186.6 million, based on the closing price of \$41.64, as reported on the New York Stock Exchange Composite Transactions.

The number of shares of common stock outstanding as of January 31, 2005: 28,955,495 shares of Common Stock, par value of \$1 per share.

Documents Incorporated by Reference

Portions of the definitive proxy statement for the 2005 annual meeting of stockholders are incorporated by reference in Part III hereof.

Table of Contents

POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

Index to 2004 Form 10-K

	Page Number
PART I	
ITEM 1. Business	2-8
ITEM 2. Properties	8
ITEM 3. Legal Proceedings	9
ITEM 4. Submission of Matters to a Vote of Security Holders	9
Executive Officers of the Registrant	9
PART II	
ITEM 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	10-11
ITEM 6. Selected Financial Data	11
ITEM 7. Management's Discussion and Analysis of Financial Condition and Results of Operations	11
ITEM 7A. Quantitative and Qualitative Disclosures About Market Risk	11
ITEM 8. Financial Statements and Supplementary Data	11
ITEM 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	11
ITEM 9A. Controls and Procedures	11-12
ITEM 9B. Other Information	12
PART III	
ITEM 10. Directors and Executive Officers of the Registrant	13
ITEM 11. Executive Compensation	13
ITEM 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	13-14
ITEM 13. Certain Relationships and Related Transactions	14
ITEM 14. Principal Accounting Fees and Services	14
PART IV	
ITEM 15. Exhibits, Financial Statement Schedules	15
SIGNATURES	16-17
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND SCHEDULES	18
EXHIBIT INDEX	71-73

PART I

ITEM 1. BUSINESS

General

Potlatch Corporation (herein referred to as the “company,” “us,” “we,” and “our”), incorporated in 1903, is a vertically integrated and diversified forest products company. We own and manage approximately 1.5 million acres of timberlands and operate 13 manufacturing facilities. Our timberland and all of our manufacturing facilities are located within the continental United States, primarily in Arkansas, Idaho, Minnesota and Nevada. We are engaged principally in growing and harvesting timber and converting wood fiber into two broad product lines: (a) commodity wood products; and (b) bleached pulp products. Our business is organized into four operating segments: Resource; Wood Products; Pulp and Paperboard; and Consumer Products.

Information relating to the amounts of net sales, operating income (loss) and identifiable assets attributable to each of our operating segments for 2002-2004 is included in Note 14 to the consolidated financial statements on pages 62-64 of this report.

Interested parties may access our periodic and current reports filed with the Securities and Exchange Commission, at no charge, by visiting our website: www.potlatchcorp.com. In the menu click on: Corporate Governance, then choose: SEC Filings. Information on our website is not part of this report.

Cautionary Statement Regarding Forward-Looking Information

This report contains, in addition to historical information, certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including without limitation, statements regarding future revenues, costs, manufacturing output, capital expenditures and timber supply issues. These forward-looking statements reflect management's current views regarding future events based on estimates and assumptions, and are therefore subject to known and unknown risks and uncertainties and are not guarantees of future performance. Our actual results of operations could differ materially from those expressed or implied by forward-looking statements contained in this report. Factors that could cause or contribute to such differences include, but are not limited to, changes in the United States and international economies; changes in exchange rates between the U.S. dollar and other currencies; changes in the level of construction activity; changes in worldwide demand for our products; changes in worldwide production and production capacity in the forest products industry; competitive pricing pressures for our products; unanticipated manufacturing disruptions; changes in general and industry-specific environmental laws and regulations; unforeseen environmental liabilities or expenditures; weather conditions; and changes in raw material, energy and other costs. Forward-looking statements contained in this report present management's views only as of the date of this report. Except as required under applicable law, we do not intend to issue updates concerning any future revisions of management's views to reflect events or circumstances occurring after the date of this report.

Raw Materials

The principal raw material used by our manufacturing operations is wood fiber, which is obtained from our own timberlands and purchased on the open market. Our Resource segment supplies fiber from our timberlands, as well as fiber purchased from outside sources, to our manufacturing facilities. In addition, most of our manufacturing segments procure fiber directly from third parties for use in their respective operations. Our Wood Products segment purchases a portion of its sawtimber log needs; our Pulp and Paperboard segment purchases a substantial amount of wood chips and sawdust

Table of Contents

from third parties for use in the production of pulp; and the Consumer Products segment purchases several varieties of pulp, in addition to pulp provided by our Pulp and Paperboard segment, which is used in manufacturing tissue products.

Information regarding 2004 fee harvests, purchases of wood fiber from third parties and sales of wood fiber to third parties are contained in the table below:

Timberland Base	Arkansas		Idaho		Minnesota	
	Sawtimber	Pulpwood	Sawtimber	Pulpwood	Sawtimber/OSB Logs*	Pulpwood
Fee Harvest (tons)	719,000	438,000	1,240,000	195,000	389,000	7,000
Purchased Fiber (tons)	1,323,000	808,000	527,000	68,000	2,052,000	11,000
Total	2,042,000	1,246,000	1,767,000	263,000	2,441,000	18,000
Tons Sold to Third Parties	386,000	387,000	585,000	11,000	193,000	18,000

* After the sale of our OSB operations in September 2004, we ceased purchasing OSB logs and began to sell OSB logs harvested from our timberlands.

In 2004, 537,000 tons of the total 4,789,000 tons of purchased sawtimber, OSB logs and pulpwood were acquired directly from timberlands owned by federal, state and local governments. Wood fiber acquisitions from these sources occur in market transactions at current market prices. We generally do not maintain long-term supply contracts for a significant volume of timber.

Timber from our lands, together with outside purchases, is presently adequate to support our manufacturing operations. For more than a decade, the timber supply from federal lands has been increasingly curtailed, largely due to environmental pressures that are expected to continue for the foreseeable future. This trend has had a favorable effect on earnings, but the long-term effect of this trend on earnings cannot be predicted.

The volume and value of timber that can be harvested from our lands may be affected by natural disasters such as fire, insect infestation, disease, ice storms, wind storms, floods and other weather conditions and causes. We assume substantially all risk of loss from fire and other hazards on the standing timber we own, as do most owners of timber tracts in the United States.

Resource Segment

The Resource segment manages our 1.5 million acres of timberlands located in Arkansas, Idaho and Minnesota, and a 17,000 acre hybrid poplar plantation in Oregon. The timberlands include a wide diversity of softwood and hardwood species. In Arkansas we own approximately 473,000 acres of timberlands. Primary species on these lands include southern yellow pine, red oak, white oak and other hardwoods. We own approximately 667,000 acres of timberlands in the northern portion of the state of Idaho. Primary species on these lands include grand fir, inland red cedar, Douglas fir, ponderosa pine, western larch, Engelmann spruce and western white pine. We own approximately 319,000 acres of timberlands in Minnesota, comprised primarily of aspen and red pine.

The segment sells wood fiber at market prices to our manufacturing facilities, as well as to third parties. We believe this maximizes our timber value and motivates management of our manufacturing segments to optimize operating efficiencies and identify profitable markets in which to compete. The Resource segment also provides fiber procurement services to some of our manufacturing facilities and uses its expertise for regional timber and log acquisitions and sales.

Table of Contents

In addition to sales to our manufacturing facilities, which accounted for 60% of the segment's net sales in 2004, the Resource segment sells wood fiber to a variety of paper and forest products companies situated within economically viable transportation distance of our timberlands. These customers range in size from small operators to multinational corporations. The segment competes with owners of timberlands that operate in areas adjacent to or near our timberlands, ranging from private owners of small tracts of land to some of the largest timberland companies in the United States. The segment competes principally on the basis of log quality, customer service and price.

The segment also sells land in the normal course of business, the majority of which is comprised of small parcels of timberland. We have intensified our efforts to manage our timberlands, which include sales of non-strategic land. Non-strategic land sales occur because the parcels do not fit our strategic plan or the parcels may be more valuable to others. As part of our strategic plan for timberlands, we also purchase parcels accretive to the business.

We own 17,000 acres of agricultural land located in northeastern Oregon, which is being developed for the production of hybrid poplar. In 2001, these development efforts were re-directed from the production of an alternate source of wood chips for pulping, with a harvest rotation of seven years, to the production of high-quality solid wood logs, with a harvest rotation of approximately 11 years. Consistent harvest of high-quality logs is expected to begin in 2006. We intend to sell hardwood sawlogs from the plantation for conversion into plywood and lumber for furniture manufacturing and other non-structural uses. Our financial success in the project will depend upon our ability to market hybrid poplar as a cost-competitive, viable alternative to other regional hardwood species, mainly red alder, which are currently used to supply the raw material needs for these products. The supply of available red alder is declining due to increased environmental restrictions in riparian areas throughout the Pacific Northwest. We believe our operation in Oregon and the positive characteristics of hybrid poplar logs produced there will enable us to compete effectively with producers of other hardwood species.

The amount of timber harvested in any year from company-owned lands varies according to the requirements of sustainable forest management. By continually improving silvicultural techniques and other forest management practices, we have been able to increase the sustainable volume of wood fiber produced per acre from our timberlands. Due to a low cost basis, on average, the cost of timber from company-owned land is substantially below the cost of timber obtained on the open market. Thus, our overall results of operations are favorably affected to the extent we can supply wood fiber from our own timberlands. We manage long-term harvest levels on our timberlands in a manner that assures sustainable yields consistent with the Sustainable Forestry Initiative[®] (SFI) Program. The SFI Program was initially developed by the American Forest & Paper Association (AF&PA) to establish principles and objectives for program participants committed to sustainable forestry and to provide measures by which the public can monitor and evaluate this commitment. The SFI Program is currently managed by an independent board (The Sustainable Forestry Board) whose members include representatives of the forest products industry as well as representatives of diversified stakeholders. As a member of AF&PA and a participant in the SFI Program, we have implemented the principles of the SFI Program: sustainable forestry, responsible practices, forest health and productivity, and protection of special sites. During 2002, an independent third party certified that management practices on our timberlands in Arkansas, Idaho and Minnesota met the requirements for SFI certification, as well as the International Organization on Standardization (ISO) 14001 standard for environmental management systems. In 2003 and 2004, our management practices on all 1.5 million acres of timberlands underwent audits which verified that these practices continue to meet the requirements of the SFI and ISO certifications. Our Boardman, Oregon, hybrid poplar plantation was certified as "well managed" in 2001 under the Forest Stewardship Council[®] (FSC) standards, and was also certified under the ISO standard in 2004. (Sustainable Forestry Initiative[®] is a registered trademark of the AF&PA. Forest Stewardship Council[®] is a registered trademark of the Forest Stewardship Council.)

Table of Contents

In 2003, the Idaho region elected to be the sole industry participant in a certification system comparison project conducted by the Pinchot Institute, initiated to understand and document similarities and differences between the SFI and FSC standards of performance, the two primary North American programs. Participation required that our Idaho timberlands undergo third party audits under both programs. In April 2004, we became the first publicly traded United States company to receive FSC third-party certification. Results of the comparison between the FSC and SFI certification systems demonstrated that both systems are similar in many respects, but each has specific strengths that, when combined, enhance our environmental management system and improve environmental performance. Our Arkansas timberlands are currently in consideration for FSC third-party certification. An audit was performed in late 2004, and we expect to receive certification by the second quarter of 2005. Our Minnesota timberlands will undergo an FSC third-party audit in 2005.

The SFI, ISO and FSC certifications will aid us in marketing our products to customers who require that products they purchase for resale have such certifications. In fact, our FSC certified lumber and plywood products were named one of 2004's Top-10 BuildingGreen products by BuildingGreen, Inc.

Since late 2002, we have worked with the Trust for Public Land to establish working-forest conservation easements on a portion of our Idaho timberlands to be held by the Idaho Department of Lands (IDL). To-date, conservation easements covering 25,700 acres of our Idaho timberlands have been conveyed to the IDL. We expect to grant additional conservation easements in 2005 and subsequent years. The easements require us to accept certain restrictions on the use of the property over which the easements are granted, such as a prohibition on converting land to residential or commercial uses. The easement terms permit the continued use of the land as a working, managed forest. Our compensation for accepting restrictions is based upon a fair-market appraisal of the rights foregone. We recognized approximately \$4.1 million and \$0.5 million in Idaho easement revenues for 2004 and 2003, respectively. Since 2003, we have also worked with the Trust for Public Land to pursue conservation easements in the Brainerd Lakes region of Minnesota covering approximately 4,800 acres of timberlands to be held by the Minnesota Department of Natural Resources. We expect to finalize conservation easements on more than half of the project in 2005. Similar conservation easements have been granted covering approximately 500 acres of our timberlands in Arkansas. Future grants of conservation easements are being considered in all of our operating regions.

Wood Products Segment

The Wood Products segment manufactures and markets lumber, plywood and particleboard. These products are sold through our sales offices primarily to wholesalers for nationwide distribution.

To produce these solid wood products, we own and operate seven manufacturing facilities in Arkansas, Idaho and Minnesota. A description of these facilities is included under Item 2 of this report.

In mid-2004, we received an unsolicited offer from Ainsworth Lumber Co. Ltd. to purchase our three oriented strand board facilities located in Minnesota. After negotiations, the sale was completed in September 2004. Financial data relating to the sale is included in this report under the heading "Discontinued Operations" in Item 1—Business, as well as throughout Management's Discussion and Analysis and Note 16 to the consolidated financial statements.

The forest products industry is highly competitive, and we compete with both smaller and substantially larger forest products companies, as well as companies that manufacture substitutes for wood and wood fiber products. Our share of the market for lumber, plywood and particleboard is not significant compared to the total United States market for these products. We believe that competitiveness in this industry is largely based on individual mill efficiency and on the availability of

Table of Contents

competitively priced resources on a facility-by-facility basis, rather than the number of mills operated. This is due to the fact that it is generally not economical to transfer wood between or among facilities, which would permit a greater degree of specialization and operating efficiencies. Instead, each facility must utilize the raw materials that are available to it in a relatively limited geographic area. For these reasons, we believe we are able to compete effectively with companies that have a larger number of mills. We compete based on product quality, customer service and price.

Pulp and Paperboard Segment

The Pulp and Paperboard segment produces and markets bleached paperboard and bleached pulp. A description of the facilities used to produce these products is included under Item 2 of this report.

We are a major producer of bleached paperboard in the United States, where we compete with at least five other domestic pulp and paperboard producers. We believe we are the third largest domestic producer of bleached paperboard, with approximately 10% of the available capacity. The business is capital intensive, which leads to high fixed costs. As a result, production generally continues as long as selling prices cover variable costs. As part of our ongoing effort to increase manufacturing efficiency and lower costs, we have allocated production of various paperboard products between our two facilities.

Bleached paperboard is a product used in the high-end segment of the packaging industry due to its strength, brightness and favorable printing and graphic surface features. Our bleached paperboard is processed by our customers into a variety of end products, including packaging for liquids and other food products, pharmaceuticals, toiletries and other consumable goods, as well as paper cups and paper plates.

We also produce and sell bleached softwood market pulp, which is used as the basis for many paper products. We do not consider ourselves among the larger manufacturers of softwood market pulp in the United States.

We utilize various methods for the sale and distribution of our paperboard and softwood pulp. In general, we sell paperboard to packaging converters domestically through sales offices located throughout the United States. The majority of our international paperboard sales are made in Japan, Korea, China and other Southeast Asian countries through sales representative offices. The majority of softwood market pulp sales are generally made through agents. Our principal methods of competing are product quality, customer service and price.

Consumer Products Segment

The Consumer Products segment produces and markets household tissue products. A description of the facilities used to produce these products is included under Item 2 of this report. In early 2004, we commenced operation of a new 102-inch through-air-dried tissue machine next to our existing tissue converting facility in Las Vegas, Nevada.

During 2004, our tissue products were manufactured on three machines at our Lewiston, Idaho, facility, as well as on the new machine at Las Vegas. The tissue was then converted into packaged tissue products at three converting facilities in Lewiston, Las Vegas, and Benton Harbor, Michigan. A fourth converting facility, in Elwood, Illinois, began operations in the middle of 2004. Approximately 61% of the pulp we used to make our tissue products was obtained from our Lewiston pulp mill. The remaining portion was purchased on the open market and consisted primarily of hardwood pulp, which enhances the quality of certain grades of tissue.

Table of Contents

We are a leading North American producer of private label household tissue products, and we produce most of the private label tissue products sold in grocery stores in the western U.S. We compete with at least three companies that are much larger than us who sell national brand tissue products, as well as commercial, industrial and private label products. We also compete with other companies who sell regional brand products and commercial, industrial and private label products. Our household tissue products (facial and bathroom tissues, paper towels and napkins) are packaged to order for retail chains, wholesalers and cooperative buying organizations throughout the United States and, to a lesser extent, Canada. These products are sold to consumers under our customers' own brand names. We sell a majority of our tissue products to three national grocery store chains. We do not have long-term supply contracts with any of these national chains and the loss of one or more of these customers could have a material adverse effect upon the operating results of the segment.

We sell tissue products to major retail outlets, primarily through brokers. Our principal methods of competing are product quality, customer service and price.

Discontinued Operations

In May 2002, we completed the sale of our Cloquet, Minnesota, pulp and printing papers facilities and certain associated assets to a domestic subsidiary of Sappi Limited for \$485.5 million in cash, after closing adjustments. In conjunction with the sale, we closed our Brainerd, Minnesota, printing papers mill and exited the coated printing papers business. As a result, we recorded an after-tax charge of \$149.8 million in the first quarter of 2002. In December 2002, we recorded an additional after-tax charge of \$14.6 million to adjust employee severance costs, the carrying value of the remaining Brainerd assets and other exit costs. We sold the Brainerd facility in February 2003 for \$4.44 million in cash. In December 2003, we recorded an after-tax charge of \$1.6 million for a continuing contractual obligation related to the Brainerd facility.

In June 2002, we announced the closure of our Bradley hardwood sawmill in Warren, Arkansas, and exit from the hardwood lumber business. An after-tax charge of \$5.7 million was recorded for estimated asset write-down and closure costs. We sold the facility in August 2002. In December 2002, we reversed \$1.6 million of the after-tax charge to reflect the actual costs incurred for the closure and sale.

On August 25, 2004, we entered into a definitive agreement for the sale of our oriented strand board facilities and related assets in Bemidji, Cook and Grand Rapids, Minnesota, to Ainsworth Lumber Co. Ltd. for approximately \$452 million in cash, after closing adjustments. The sale was completed in September 2004. We recorded an after-tax gain on the sale of \$163.1 million in the third quarter of 2004.

Environment

Information regarding environmental matters is included under Item 7—"Management's Discussion and Analysis of Financial Condition and Results of Operations" on pages 36-37 of this report.

Employees

As of December 31, 2004, we had approximately 3,700 full-time employees. The workforce consisted of approximately 900 salaried, 2,800 hourly and 100 temporary or part-time employees. As of December 31, 2004, approximately 57% of the workforce was covered under collective bargaining agreements.

Table of Contents

Hourly union labor contracts expiring in 2005 are set forth below.

<u>Contract Expiration Date</u>	<u>Location</u>	<u>Union</u>	<u>Approximate Number of Hourly Employees</u>
May 8	Wood Products Division & Resource Management Division Warren, Arkansas	International Association of Machinists & Aerospace Workers	250

ITEM 2. PROPERTIES

For information regarding our timberlands, see the discussion under the heading “Resource Segment” on pages 3-5 of this report. Our principal manufacturing facilities at December 31, 2004, which are all owned by us except as noted, together with their respective 2004 annual capacities and production, are as follows:

	<u>Capacity (A)</u>	<u>Production (A)</u>
Wood Products		
Sawmills:		
Prescott, Arkansas	225,000 mbf	220,000 mbf
Warren, Arkansas	225,000 mbf	210,000 mbf
Lewiston, Idaho	175,000 mbf	174,000 mbf
St. Maries, Idaho	115,000 mbf	112,000 mbf
Bemidji, Minnesota	100,000 mbf	98,000 mbf
Plywood Mill (B):		
St. Maries, Idaho	160,000 msf	155,000 msf
Particleboard Mill (C):		
Post Falls, Idaho	70,000 msf	63,000 msf
Pulp and Paperboard		
Pulp Mills:		
Cypress Bend, Arkansas	280,000 tons	279,000 tons
Lewiston, Idaho	540,000 tons	523,000 tons
Bleached Paperboard Mills:		
Cypress Bend, Arkansas	300,000 tons	299,000 tons
Lewiston, Idaho	420,000 tons	411,000 tons
Consumer Products		
Tissue Mills:		
Lewiston, Idaho	180,000 tons	178,000 tons
Las Vegas, Nevada (D)	30,000 tons	25,000 tons
Tissue Converting Facilities:		
Lewiston, Idaho	110,000 tons	110,000 tons
Elwood, Illinois (E)	15,000 tons	4,000 tons
Benton Harbor, Michigan (F)	10,000 tons	7,000 tons
Las Vegas, Nevada	50,000 tons	47,000 tons

(A) msf stands for thousand square feet; mbf stands for thousand board feet.

(B) 3/8 inch panel thickness basis.

(C) 3/4 inch panel thickness basis.

(D) Commenced operations in 2004. Capacity shown is rated capacity.

(E) Commenced operations in 2004. Building is leased, operating equipment is owned. Capacity shown is rated capacity.

(F) Building and operating equipment are leased. Lease expires in May 2005.

ITEM 3. LEGAL PROCEEDINGS

In late January 2004, we voluntarily reported to the Minnesota Pollution Control Agency (MPCA) a potential air permit violation at our former oriented strand board facility in Bemidji, Minnesota (sold in September 2004), relating to the non-operation of equipment used to control nitrous oxide emissions from a wood-fired boiler for a period of approximately 29 months. Corrective action was taken, and we have cooperated with the MPCA in its investigation. The MPCA has completed its investigation, and we and the MPCA are discussing a proposed settlement agreement, including the amount of a proposed penalty, which we believe will be less than \$1 million. We have established a reserve in accordance with Statement of Financial Accounting Standards (SFAS) No. 5, "Accounting for Commitments and Contingencies."

Taking into consideration the amount of the proposed penalty to be assessed in the above described matter, we believe there is no pending or threatened litigation that would have a material adverse effect on our financial position, operations or liquidity.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

There were no matters submitted to a vote of security holders during the fourth quarter of the fiscal year ended December 31, 2004.

EXECUTIVE OFFICERS OF THE REGISTRANT

Information as of March 1, 2005, and for at least the past five years concerning the executive officers of the company is as follows:

L. Pendleton Siegel (age 62), first elected an officer in 1983, has served as Chairman of the Board and Chief Executive Officer since May 1999. Mr. Siegel was elected a director of the company effective November 1997. He is a member of the Finance Committee of the Board of Directors.

Robert P. DeVleming (age 52), first elected an officer in 1999, has served as Vice President, Consumer Products Division, since October 2004. From May 2003 through October 2004, he was Vice President, Sales, Consumer Products Division. From August 2002 through May 2003, he was Vice President, Tissue Expansion, Consumer Products Division. From May 1999 through August 2002, he was Vice President, Marketing and Sales, Consumer Products Division.

Richard K. Kelly (age 57), first elected an officer in 1999, has served as Vice President, Wood Products Division, since July 1999.

John R. Olson (age 56), first elected an officer in 1999, has served as Vice President, Resource Management Division, since May 1999.

Harry D. Seamans (age 51), first elected an officer in 2003, has served as Vice President, Pulp and Paperboard Division, since January 2003. From March 2000 through December 2002, he was Arkansas Pulp and Paperboard Mill Manager.

Gerald L. Zuehlke (age 56), first elected an officer in 1994, has served as Vice President, Finance, and Chief Financial Officer since June 2000. From June 1994 through March 2004, he also served as Treasurer.

NOTE: The aforementioned officers of the company hold office until the officer's successor has been duly elected and has qualified or until the earlier of the officer's death, resignation, retirement or removal by the board.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The company's common stock is traded on the New York, Chicago and Pacific Stock Exchanges. The quarterly and yearly high and low sales price per share of our common stock, as reported in the New York Stock Exchange Composite Transactions for 2004 and 2003 were as follows:

Quarter	2004		2003	
	High	Low	High	Low
1 st	\$43.55	\$35.46	\$25.10	\$18.75
2 nd	41.83	34.77	26.10	20.00
3 rd	46.81	37.61	31.90	25.35
4 th	51.90	44.00	35.95	29.90
Year	51.90	34.77	35.95	18.75

In general, all holders of Potlatch common stock who own shares 48 consecutive calendar months or longer ("long-term holders") are entitled to exercise four votes per share of stock so held (commonly referred to as time-phased voting), while stockholders who are not long-term holders are entitled to one vote per share. All stockholders are entitled to only one vote per share on matters arising under certain provisions of the company's charter. In January 2005, the board of directors announced that it will propose an amendment to the company's restated certificate of incorporation to eliminate time-phased voting rights for Potlatch's common stock. Stockholders will vote on the proposal at our Annual Meeting to be held in May 2005. Time-phased voting will apply to the stockholder vote on the proposal. The affirmative vote of a majority of the voting power outstanding and entitled to vote is required for approval of the amendment. Further information regarding this proposal can be obtained by referring to our definitive proxy statement for the 2005 annual meeting of stockholders. There were approximately 1,650 stockholders of record at December 31, 2004.

The board of directors annually reviews and approves the dividend policy. The board considers a variety of factors in determining whether to pay a dividend and the dividend rate, including, among other things, conditions in the forest products industry and the economy in general, dividend payments in the forest products industry, our operating results and cash flows, anticipated capital expenditures and compliance with the terms of any debt instrument that limit the payment of dividends on our common stock. The quarterly dividend rate is subject to change from time to time based on the board's business judgment with respect to these and other relevant factors. Regular quarterly dividend payments per common share for 2004 and 2003 were:

Quarter	2004	2003
1 st	\$.15	\$.15
2 nd	.15	.15
3 rd	.15	.15
4 th	.15	.15
	<u>\$.60</u>	<u>\$.60</u>

In addition to the regular quarterly dividend payments, a \$2.50 per common share special dividend was paid in the fourth quarter of 2004. The dividend represented one part of our board of directors' authorization to return to shareholders a portion of the proceeds received from the sale of our OSB operations.

Table of Contents

The second part of the board of directors' authorization was in the form of a \$75 million accelerated stock repurchase program, which was announced on October 25, 2004. Information on the stock repurchase is contained in the following table.

Date	Total number of shares purchased	Average price per share	Total shares	Total shares
			purchased as part of publicly announced program	that may yet be purchased under the program
November 11, 2004	1,560,397	\$ 48.29	1,560,397	—

The average price paid per share is subject to adjustment for the volume weighted average price per share paid by the financial counterparty that facilitated the accelerated stock repurchase. The counterparty will purchase shares for its own account in the open market over a nine-month period ending in August 2005, equaling the shares we repurchased. Further information with respect to the accelerated stock repurchase program is set forth under the heading "Quantitative and Qualitative Disclosures About Market Risk" on pages 37-39.

The accelerated stock repurchase program superseded a plan approved in December 1999, authorizing the repurchase of up to two million shares. Through December 2001, a total of 910,900 shares had been repurchased under the superseded plan.

ITEMS 6, 7, 7A and 8

The information called for by Items 6, 7, 7A and 8, inclusive, of Part II of this form is contained in the following sections of this report at the pages indicated below:

	Page Number
ITEM 6	19
ITEM 7	19-37
ITEM 7A	37-39
ITEM 8	40-70

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

We maintain "disclosure controls and procedures," as such term is defined in Rule 13a-14(c) under the Securities and Exchange Act of 1934 (the Exchange Act), that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that

Table of Contents

the objectives of the disclosure controls and procedures are met. Additionally, in designing disclosure controls and procedures, our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Subject to the limitations noted above, our management, with the participation of our CEO and CFO, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the fiscal year covered by the annual report on this Form 10-K. Based on that evaluation, the CEO and CFO have concluded that, as of such date, our disclosure controls and procedures are effective to meet the objective for which they were designed and operate at the reasonable assurance level.

Management's Annual Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rule 13a-15(f) under the Exchange Act.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management, with the participation of the CEO and CFO, assessed the effectiveness of our internal control over financial reporting as of December 31, 2004. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework.

Based on our assessment, management believes that, as of December 31, 2004, our internal control over financial reporting is effective based on those criteria.

Our independent auditors have issued an audit report on our assessment of our internal control over financial reporting. This report appears on pages 67-69.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Information regarding the directors of our company is set forth under the heading “Board of Directors” in our definitive proxy statement, dated March 30, 2005, for the 2005 annual meeting of stockholders (2005 Proxy Statement), which information is incorporated herein by reference. Information concerning Executive Officers is included in Part I of this report following Item 4. Information regarding reporting compliance with Section 16(a) for directors, officers or other parties is set forth under the heading “Section 16(a) Beneficial Ownership Reporting Compliance” in the 2005 Proxy Statement and is incorporated herein by reference.

We have adopted a Corporate Conduct and Ethics Code that applies to all directors and employees. You can find our Corporate Conduct and Ethics Code on our website by going to the following address: www.potlatchcorp.com, clicking on Corporate Governance, and then clicking on the link for Corporate Conduct and Ethics Code. We will post any amendments, as well as any waivers that are required to be disclosed by the rules of either the Securities and Exchange Commission or the New York Stock Exchange, on our website. To-date, no waivers to the Corporate Conduct and Ethics Code have been considered or granted.

Our board of directors has adopted Corporate Governance Guidelines and charters for the board of directors’ Audit Committee, Executive Compensation and Personnel Policies Committee, and Nominating and Corporate Governance Committee. You can find these documents on our website by going to the following address: www.potlatchcorp.com, clicking on Corporate Governance, and then clicking on the appropriate link.

You can also obtain a printed copy of any of the materials referred to above by contacting us at the following address:

Potlatch Corporation
Attention: Mac Ryerse, Corporate Secretary
601 West Riverside Ave., Suite 1100
Spokane, Washington 99201
Telephone: (509) 835-1500

The Audit Committee of our board of directors is an “audit committee” for purposes of Section 3(a)(58) of the Securities Exchange Act of 1934. As of December 31, 2004, the members of that committee were: Boh A. Dickey (Chair), Ruth Ann M. Gillis, Jerome C. Knoll, and Gregory L. Quesnel. The board of directors has determined that Mr. Dickey is an “audit committee financial expert” and that he and all of our Audit Committee members are “independent” as defined under the applicable rules and regulations of the Securities and Exchange Commission and the listing standards of the New York Stock Exchange.

ITEM 11. EXECUTIVE COMPENSATION

Information set forth under the heading “Compensation of the Named Executive Officers” in the 2005 Proxy Statement is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Information regarding any person or group known by us to be the beneficial owner of more than five percent of our common stock as well as the security ownership of management set forth under the heading “Stock Ownership” in the 2005 Proxy Statement is incorporated herein by reference.

Table of Contents

The following table provides certain information as of December 31, 2004, with respect to our equity compensation plans:

Plan category	Number of securities to be issued upon exercise of outstanding options (1)	Weighted average exercise price of outstanding options	Number of securities remaining available for future issuance under equity compensation plans
Equity compensation plans approved by security holders	1,535,468	\$ 37.23	313,007
Equity compensation plans not approved by security holders	—	—	—
Total	1,535,468	\$ 37.23	313,007

- (1) Includes 227,653 performance shares, which is the maximum number of shares that could be awarded under the performance share program, not including future dividend equivalents. Performance shares are not included in the weighted average exercise price calculation.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Not applicable.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

Information set forth under the heading “Fees Paid to Independent Auditor in 2004 and 2003” in the 2005 Proxy Statement is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

Consolidated Financial Statements

Our consolidated financial statements are listed in the Index to Consolidated Financial Statements and Schedules on page 18 of this Form 10-K.

Financial Statement Schedules

Our financial statement schedules are listed in the Index to Consolidated Financial Statements and Schedules on page 18 of this Form 10-K.

Exhibits

Exhibits are listed in the Exhibit Index on pages 71-73 of this Form 10-K.

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the company has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

POTLATCH CORPORATION
(Registrant)

By /s/ L. P ENDLETON S IEGEL

L. Pendleton Siegel
Chairman of the Board
and Chief Executive Officer

Date: February 25, 2005

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below on February 25, 2005, by the following persons on behalf of the company in the capacities indicated.

By /s/ L. P ENDLETON S IEGEL

L. Pendleton Siegel

Director and Chairman of the Board and Chief Executive Officer (Principal Executive Officer)

By /s/ G ERALD L. Z UEHLKE

Gerald L. Zuehlke

Vice President, Finance, Chief Financial Officer
(Principal Financial Officer)

By /s/ TERRY L. CARTER

Terry L. Carter

Controller (Principal Accounting Officer)

*

Director

Boh A. Dickey

*

Director

William L. Driscoll

*

Director

Ruth Ann M. Gillis

*

Director

Jerome C. Knoll

*

Director

Lawrence S. Peiros

*

Director

Gregory L. Quesnel

*

Director

Michael T. Riordan

Table of Contents

	*	Director
	Judith M. Runstad	
	*	Director
	Dr. William T. Weyerhaeuser	
*By	/ s / M ALCOLM A. R YERSE	
	Malcolm A. Ryerse (Attorney-in-fact)	

Table of Contents

POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

Index to Consolidated Financial Statements and Schedules

The following documents are filed as part of this report:

	Page Number
Selected Financial Data	19
Management's Discussion and Analysis of Financial Condition and Results of Operations	19-37
Consolidated Financial Statements:	
Consolidated Statements of Operations and Comprehensive Income for the years ended December 31, 2004, 2003 and 2002	40
Consolidated Balance Sheets at December 31, 2004 and 2003	41
Consolidated Statements of Cash Flows for the years ended December 31, 2004, 2003 and 2002	42
Consolidated Statements of Stockholders' Equity for the years ended December 31, 2004, 2003 and 2002	43
Summary of Principal Accounting Policies	44-48
Notes to Consolidated Financial Statements	49-66
Reports of Independent Registered Public Accounting Firm	67-69
Schedules:	
II. Valuation and Qualifying Accounts	70
All other schedules are omitted because they are not required, not applicable or the required information is given in the consolidated financial statements.	

Potlatch Corporation and Consolidated Subsidiaries

Selected Financial Data
(Dollars in thousands — except per-share amounts)

	2004	2003	2002	2001	2000
Net sales	\$1,351,472	\$1,192,437	\$1,106,306	\$1,111,811	\$1,087,464
Earnings (loss) from continuing operations	15,330	(3,842)	(41,221)	(43,597)	(47,768)
Net earnings (loss)	271,249	50,727	(234,381)	(79,445)	(33,214)
Working capital	255,065	303,776	258,839	784,528	919,290
Current ratio	2.7 to 1	2.8 to 1	2.0 to 1	2.4 to 1	3.1 to 1
Long-term debt (including current portion)	\$ 336,522	\$ 618,785	\$ 638,252	\$1,150,125	\$ 801,874
Stockholders' equity	671,389	470,851	430,791	707,304	813,236
Long-term debt to stockholders' equity ratio	0.5 to 1	1.3 to 1	1.5 to 1	1.6 to 1	.99 to 1
Capital expenditures	\$ 48,900	\$ 76,090	\$ 48,924	\$ 29,365	\$ 80,894
Total assets	1,594,672	1,597,377	1,624,817	2,488,439	2,542,445
Basic earnings (loss) from continuing operations per common share	\$ 0.52	\$ (0.13)	\$ (1.45)	\$ (1.54)	\$ (1.67)
Basic net earnings (loss) per common share	9.23	1.77	(8.23)	(2.81)	(1.16)
Average common shares outstanding (in thousands)	29,397	28,706	28,462	28,282	28,523
Diluted earnings (loss) from continuing operations per common share	\$ 0.52	\$ (0.13)	\$ (1.45)	\$ (1.54)	\$ (1.67)
Diluted net earnings (loss) per common share	9.19	1.77	(8.23)	(2.81)	(1.16)
Average common shares outstanding, assuming dilution (in thousands)	29,515	28,718	28,462	28,282	28,523
Cash dividends per common share ¹	\$ 3.10	\$.60	\$.60	\$ 1.17	\$ 1.74

Certain amounts for 2000-2003 have been reclassified to conform to the 2004 presentation as a result of the divestiture of the OSB operations.

¹ Cash dividends for 2004 included a special dividend of \$2.50 per common share.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

We are a vertically integrated and diversified forest products company. We own approximately 1.5 million acres of timberland and operate 13 manufacturing facilities, located primarily in Arkansas, Idaho, Minnesota and Nevada. Our business is organized into four segments:

- The Resource segment manages our timberlands, which supply logs, wood chips, pulpwood and other wood fiber to our manufacturing segments, as well as to third parties. Intersegment sales are based on prevailing market prices for wood fiber. In 2004, Resource segment net

Table of Contents

sales were \$274.3 million, representing approximately 17% of our net sales, before elimination of intersegment sales. Intersegment sales were \$164.4 million in 2004.

- The Wood Products segment manufactures lumber, plywood and particleboard at seven mills located in Arkansas, Idaho and Minnesota. These products are largely commodity products, which are sold to wholesalers primarily for use in home building and other construction activity. Wood Products segment net sales were \$451.0 million in 2004, representing approximately 29% of our net sales, before elimination of intersegment sales. Intersegment sales were \$12.0 million in 2004.
- The Pulp and Paperboard segment manufactures bleached paperboard used in packaging and bleached softwood market pulp. The Pulp and Paperboard segment operates two pulp and paperboard mills located in Arkansas and Idaho. Pulp and Paperboard segment net sales were \$529.3 million in 2004, representing approximately 34% of our net sales, before elimination of intersegment sales. Intersegment sales were \$46.7 million in 2004.
- The Consumer Products segment manufactures tissue products primarily sold on a private label basis by major grocery store chains. In 2004 the Consumer Products segment operated two tissue mills with related converting facilities in Idaho and Nevada, and two additional converting facilities located in Illinois and Michigan. Consumer Products segment net sales were \$320.1 million in 2004, representing approximately 20% of our net sales, before elimination of intersegment sales. Intersegment sales were \$0.1 million in 2004.

In May 2002, we exited our Printing Papers segment, which produced primarily high-grade coated printing papers and bleached hardwood market pulp. We sold our Cloquet, Minnesota, pulp and printing papers facilities and certain associated assets to a domestic subsidiary of Sappi Limited for \$485.5 million in cash, after closing adjustments. We closed our Brainerd, Minnesota, printing papers mill at the same time. That facility was sold in February 2003 for \$4.44 million in cash.

In June 2002, we announced that we would close our Bradley hardwood mill in Warren, Arkansas, and exit the hardwood lumber business. We sold the facility in August 2002.

In September 2004, we sold our OSB mills and related assets in Bemidji, Cook and Grand Rapids, Minnesota, to Ainsworth Lumber Co. Ltd. for approximately \$452 million in cash, after closing adjustments.

Our consolidated financial statements and this discussion reflect the classification of the Printing Papers segment, the Bradley hardwood mill and the OSB operations as discontinued operations for all periods presented. Our discontinued operations generated after-tax operating earnings (losses) of \$92.8 million, \$56.2 million and \$(24.7) million for the years ended December 31, 2004, 2003 and 2002, respectively. Cash flows generated by discontinued operations totaled \$585.0 million, \$98.2 million and \$426.3 million for the years ended December 31, 2004, 2003 and 2002, respectively.

The majority of the proceeds from the sale of the printing papers operations in 2002 were used to retire over \$400 million of debt. Proceeds from the sale of the OSB operations in 2004 were used to retire an additional \$281.8 million of debt, make a pension contribution of \$57.9 million, pay a special cash dividend of \$2.50 per common share, which totaled approximately \$75 million, and to repurchase \$75 million of company stock through an accelerated stock repurchase program. The retirement of the debt has decreased our interest expense in subsequent periods and improved our standing under financial ratios contained in the financial maintenance covenants in our unsecured bank credit facility.

Factors Influencing Our Results of Operations

Our operating results have been and will continue to be influenced by a variety of factors, including the cyclical nature of the forest products industry, competition, international trade

Table of Contents

agreements or disputes, the efficiency and level of capacity utilization of our manufacturing operations, changes in our principal expenses, such as wood fiber and energy costs, changes in harvest levels from our timberlands, changes in the production capacity of our manufacturing operations as a result of major capital spending projects, asset dispositions or acquisitions and other factors.

Our operating results generally reflect the cyclical pattern of the forest products industry. Historical prices for our products have been volatile, and we, like other manufacturers in the forest products industry, have limited direct influence over the timing and extent of price changes for our products. Product pricing is significantly affected by the relationship between supply and demand. Product supply is influenced primarily by fluctuations in available manufacturing capacity. Demand is affected by the state of the economy in general and a variety of other factors. The demand for our timber resources and wood products is affected by the level of new residential construction activity and, to a lesser extent, home repair and remodeling activity, which are subject to fluctuations due to changes in economic conditions, interest rates, population growth, weather conditions and other factors. The demand for most of our pulp and paperboard products is primarily affected by the general state of the global economy, and the economies in North America and east Asia in particular. The demand for our tissue products is primarily affected by the state of the United States economy.

The markets for our products are highly competitive and companies that have substantially greater financial resources than we do compete with us in each of our lines of business. Logs and other fiber from our timberlands, as well as our wood products, are subject to competition from timberland owners and wood products manufacturers in North America and to a lesser extent in South America, Europe, Australia and New Zealand. Our pulp-based products, other than tissue products, are globally-traded commodity products. Because our competitors in these segments are located throughout the world, variations in exchange rates between the U.S. dollar and other currencies can significantly affect our competitive position compared to our international competitors. As it is generally not profitable to sell tissue products overseas due to high transportation costs, currency exchange rates do not have a major effect on our ability to compete in our tissue business.

Tariffs, quotas or trade agreements can also affect the markets for our products, particularly our wood products. In 2002, the United States imposed duties on imported lumber from Canada in response to a dispute over the stumpage policies of some provincial governments. Negotiations continue between the two countries to resolve the dispute, although both countries are pursuing their own independent litigation and administrative remedies. Any resulting agreement or other determination could have a significant effect on lumber markets in the United States.

Our industry is capital intensive, which leads to high fixed costs and generally results in continued production as long as prices are sufficient to cover variable costs. These conditions have contributed to substantial price competition, particularly during periods of reduced demand. Some of our competitors may currently be lower-cost producers in some of the businesses in which we operate, and accordingly these competitors may be less adversely affected than we are by price decreases. No downtime was taken at any of our facilities due to an inability to cover variable costs in any of the periods presented. However, our Warren and Prescott, Arkansas, lumber facilities took downtime during 2004 due to shortages of logs attributable to exceptionally wet conditions that curtailed logging operations. Downtime was also taken in 2004 at our particleboard facility to align inventory volumes with market conditions.

Energy has become one of our most volatile operating expenses over the past several years. Energy costs were higher for 2004, compared to 2003, due primarily to increased natural gas usage as a result of operating our new through-air-dried tissue machine in Las Vegas, Nevada. Compared with 2002, energy costs rose overall in 2003, but in varying amounts across our operating regions. In

Table of Contents

periods of high energy prices, market conditions may prevent us from passing higher energy costs on to our customers through price increases and therefore such higher energy costs could adversely affect our operating results. We have taken steps through conservation and electrical production to reduce our exposure to the volatile spot market for energy and to rate increases by regulated utilities. Our energy costs in future periods will depend principally on our ability to continue to produce a substantial portion of our electricity needs internally and on changes in market prices for natural gas. From time to time we have entered into derivative financial instruments as a hedge against potential increases in the cost of natural gas. We entered into several such contracts in the third quarter of 2003, covering a portion of our expected natural gas purchases from November 2003 through March 2004. We have not entered into any such contracts since March 2004.

Another significant expense is the cost of wood fiber needed to supply our manufacturing facilities. Our overall results of operations are favorably affected to the extent we can supply wood fiber from our own timberlands, due to its low cost basis relative to wood fiber purchased on the open market. The percentage of our wood fiber requirements supplied by our timberlands will fluctuate based on a variety of factors, including changes in our timber harvest levels, weather, changes in our manufacturing capacity and changes in the amount of timber sales to third parties. The cost of various types of wood fiber that we purchase in the market has at times fluctuated greatly because of economic or industry conditions. Selling prices of our products have not always increased in response to wood fiber price increases, nor have wood fiber prices always decreased in conjunction with declining product prices. On occasion, our results of operations have been and may in the future be adversely affected if we are unable to pass cost increases through to our customers.

The disparity between cost of wood fiber harvested from our fee timberlands and the cost of wood fiber purchased on the open market is due to the fact that the capitalized costs to establish fee timber were expended many years ago. The initial stand establishment costs remain as a capitalized asset until the timber reaches maturity, which typically ranges from 30 to 60 years. On-going forest management costs include recurring items necessary to the ownership and administration of timber producing property and are expensed as incurred. The cost of purchased wood fiber is significantly higher due to the fact that the wood fiber being purchased from third parties is mature and is sold by them at the current market price.

The cost of timber harvested in 2004, as disclosed in Note 4 to the consolidated financial statements, increased \$0.4 million compared to 2003, while it decreased \$1.4 million in 2003 from 2002. Because timber-growing is a long-term business, the variation between these amounts is not unusual. Such variances are due to factors discussed in the preceding paragraphs. The tons of timber purchased increased in 2002 and 2003, but decreased in 2004, largely as a result of the sale of our OSB operations. Harvested tons and tons sold also increased in 2002 and 2003 but were flat in 2004. Harvested tons as a percentage of total harvested and purchased tons for each year was 38%, 37% and 37% for 2004, 2003 and 2002, respectively. The tons sold to third parties for each of the years presented compared to total harvested and purchased tons was 19%, 18% and 10%, respectively.

Finally, changes in our manufacturing capacity, primarily as a result of capital spending programs or asset dispositions, have significantly affected our results of operations in recent periods. In May 2002, we sold a majority of our Printing Papers segment assets to a domestic subsidiary of Sappi Limited and exited the printing papers business. In August 2002, we sold a hardwood sawmill in Arkansas. During 2004, a newly constructed tissue machine in Las Vegas, Nevada, began operation and was near full operating production of 30,000 tons per year by year's end. In June 2004, we began operating a tissue converting facility in Elwood, Illinois. In September 2004, we sold our three OSB operations in Bemidji, Cook and Grand Rapids, Minnesota. Each of these changes has affected or will affect our levels of net sales and expenses, as well as the comparability of our operating results from period to period. Additionally, the profitability of our manufacturing segments depends largely on our

Table of Contents

ability to operate our manufacturing facilities efficiently and at or near full capacity. Our operating results would be adversely affected if market demand does not justify operating at these levels or if our operations are inefficient or suffer significant interruption for any reason.

Critical Accounting Policies

Our principal accounting policies are discussed on pages 44-48 of this Form 10-K. The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported financial position and operating results of the company. Management believes the accounting policies discussed below represent the most complex, difficult and subjective judgments it makes in this regard.

Long-lived assets . Due to the capital-intensive nature of our industry, a significant portion of our total assets are invested in our manufacturing facilities. Also, the cyclical patterns of our businesses cause cash flows to fluctuate by varying degrees from period to period. As a result, long-lived assets are a material component of our financial position with the potential for material change in valuation if assets are determined to be impaired. We account for impairment of long-lived assets in accordance with Financial Accounting Standards Board (FASB) SFAS No. 144. The statement requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable, as measured by its undiscounted estimated future cash flows. We use our operational budgets to estimate future cash flows. Budgets are inherently uncertain estimates of future performance due to the fact that all inputs (revenues, costs, capital spending) are subject to frequent change for many different reasons, as previously described in "Factors Affecting Our Results of Operations." Because of the number of variables involved, the interrelationship between the variables and the long-term nature of the impairment measurement, sensitivity analysis of individual variables is not practical. Budget estimates are adjusted periodically to reflect changing business conditions and operations are reviewed, as appropriate, for impairment using the most current data available. To date, this process has not resulted in an impairment charge for any of our assets.

Timber and timberlands . Timber and timberlands are recorded at cost, net of fee timber harvested. Expenditures for reforestation, including all costs related to stand establishment, such as site preparation, costs of seeds or seedlings and tree planting, are capitalized. Expenditures for forest management, consisting of regularly recurring items necessary to the ownership and administration of our timber and timberlands, are accounted for as current operating expense. Our cost of timber harvested is determined based on costs capitalized and the related current estimated recoverable timber volume. Recoverable volume does not include anticipated future growth, nor are anticipated future costs considered.

There are currently no authoritative accounting rules relating to costs to be capitalized in timber and timberlands. We have used relevant portions of current accounting rules, industry practices and our judgment in determining costs to be capitalized or expensed. Alternate interpretations and judgments could significantly affect the amounts capitalized. Additionally, models and observations used to estimate the current recoverable timber volume on our lands are subject to judgments that could significantly affect volume estimates. For example, harvest cycles can vary by geographic region and by species of timber, weather patterns can affect harvest cycles, environmental regulations and restrictions may limit the company's ability to harvest certain timberlands, changes in harvest plans may occur, or scientific advancement in seedlings and timber growing technology may affect future harvests. Different assumptions for either the cost or volume estimates, or both, could have a significant effect upon amounts reported in our statements of operations and financial condition. Because of the number of variables involved and the interrelationship between the variables, sensitivity analysis of individual variables is not practical.

Table of Contents

Restructuring charges and discontinued operations . In 2002, we recorded charges for the reduction of the hourly workforce at a manufacturing site and a reduction of our salaried workforce. In May 2002, we completed the sale of a majority of the assets of our Printing Papers segment and closed a printing papers facility in Brainerd, Minnesota, which was subsequently sold in 2003. In July 2002, we closed a hardwood lumber mill in Warren, Arkansas. The mill was sold in August 2002. In January 2004, we recorded a charge for a workforce reduction in our Consumer Products segment. In September 2004, we sold our three OSB operations in Minnesota. These events required us to record estimates of liabilities for employee benefits, environmental clean-up and other costs at the time of the events. In making these judgments, we considered contractual obligations, legal liabilities, and possible incremental costs incurred as a result of restructuring plans to determine the liability. Our estimated liabilities could differ materially from actual costs incurred, with resulting adjustments to future period earnings for any differences, although no material adjustments to our original estimates have occurred for the events described above.

Environmental liabilities . We record accruals for estimated environmental liabilities in accordance with SFAS No. 5, "Accounting for Commitments and Contingencies." These estimates reflect assumptions and judgments as to the probable nature, magnitude and timing of required investigation, remediation and monitoring activities. In making these estimates, we consider, among other things, the activities we have conducted at any particular site, information obtained through consultation with applicable regulatory authorities and third-parties, and our historical experience at other sites that are judged to be comparable. We must also consider the likelihood of changes in governmental regulations, advancements in environmental technologies, and changing legal standards regarding liability. Due to the numerous uncertainties and variables associated with these assumptions and judgments, and changes in governmental regulations and environmental technologies, our accruals are subject to substantial uncertainties and our actual costs could be materially more or less than the estimated amounts.

Pension and postretirement benefits . The determination of pension plan expense and the requirements for funding our pension plans are based on a number of actuarial assumptions. Two critical assumptions are the discount rate applied to pension plan obligations and the rate of return on plan assets. For other postretirement employee benefit (OPEB) plans, which provide certain health care and life insurance benefits to qualified retired employees, critical assumptions in determining OPEB expense are the discount rate applied to benefit obligations and the assumed health care cost trend rates used in the calculation of benefit obligations.

Note 11 to the consolidated financial statements on pages 56-60 includes information for the three years ended December 31, 2004, on the components of pension and OPEB expense, the underlying actuarial assumptions used to calculate periodic expense, as well as the funded status for our pension and OPEB plans as of December 31, 2004 and 2003.

The discount rate used in the determination of pension benefit obligations and pension expense is based on high-quality fixed income investment interest rates. At December 31, 2004, we calculated obligations using a 5.90% discount rate. The discount rates used at December 31, 2003 and 2002 were 6.25% and 6.75%, respectively. To determine the expected long-term rate of return on pension assets, we employ a process that analyzes historical long-term returns for various investment categories, as measured by appropriate indices. These indices are weighted based upon the extent to which plan assets are invested in the particular categories in arriving at our determination of a composite expected return. The assumed long-term rate of return on pension plan assets used for the three-year period ended December 31, 2004, was 9.5%. Over the past 27 years, the period we have actively managed pension assets, our actual average annual return on pension plan assets has been approximately 12%.

Table of Contents

An increase in the discount rate or the expected return on plan assets, all other assumptions remaining the same, would reduce pension plan expense, and conversely, a decrease in either of these measures would increase plan expense. Total periodic pension plan income in 2004 was \$11.5 million. As an indication of the sensitivity that pension expense has to the discount rate assumption, a 25 basis point change in the discount rate would affect plan expense by approximately \$1.3 million. A 25 basis point change in the assumption for expected return on plan assets would affect plan expense by approximately \$1.6 million. The actual rates on plan assets may vary significantly from the assumption used because of unanticipated changes in financial markets.

We estimate contributions to our pension plans will total approximately \$1.4 million in 2005.

For our OPEB plans, expense for 2004 was \$25.2 million. The discount rate used to calculate OPEB obligations was 5.90% at December 31, 2004, and 6.25% and 6.75% at December 31, 2003 and 2002, respectively. The assumed health care cost trend rate used to calculate OPEB obligations and expense for 2004 was a 7% increase over the previous year, with the rate of increase scheduled for adjustment to 12% in 2005 and declining 1 percent annually to a long-term ultimate rate increase assumption of 6% for 2011 and thereafter.

As an indication of the sensitivity that OPEB expense has to the discount rate assumption, a 25 basis point change in the discount rate would affect plan expense by approximately \$0.8 million. A 1% change in the assumption for health care cost trend rates would have affected 2004 plan expense by approximately \$2.2-\$2.7 million and the total postretirement obligation by approximately \$30.3-\$35.6 million, as reported in Note 11 on page 58. The actual rates of health care cost increases may vary significantly from the assumption used because of unanticipated changes in health care costs.

Periodic pension and OPEB expense are included in "Materials, labor and other operating expenses" and "Selling, general and administrative expenses" in the statements of operations. The expense is allocated to all business segments. Depending upon the funded status of the different plans, either a long-term asset or long-term liability is recorded for plans with overfunding or underfunding, respectively. Any unfunded accumulated pension benefit obligation in excess of recorded liabilities is accounted for in "Accumulated other comprehensive loss". See Note 11 on pages 56-60 for related balance sheet effects at December 31, 2004 and 2003.

Results of Operations

At December 31, 2004, our business was organized into four reporting segments: Resource, Wood Products, Pulp and Paperboard, and Consumer Products. Sales or transfers between segments are recorded as intersegment sales based on prevailing market prices. Because of the role of the Resource segment in supplying our manufacturing segments with wood fiber, intersegment sales represent a significant portion of the Resource segment's total net sales. Intersegment sales represent a substantially smaller percentage of net sales for our other segments. Beginning in the third quarter of 2002, our Wood Products and Pulp and Paperboard operating segments transitioned to a fiber procurement system where a portion of third party fiber purchases are made directly by each of these segments, rather than from the Resource segment. The change in the fiber procurement system has significantly decreased intersegment sales for the Resource segment and decreased fiber purchases by the Resource segment from third parties.

In the period-to-period discussion of our results of operations below, when we discuss our consolidated net sales, contributions by each of the segments to our net sales are reported after elimination of intersegment sales. In the "Discussion of Business Segments" sections below, each segment's net sales are set forth before elimination of intersegment sales.

Table of Contents

As a result of our decisions to sell our Printing Papers segment assets, the OSB operations and associated assets, and to close the Bradley hardwood sawmill, those operations have been classified as “discontinued operations” and “assets held for sale” in the consolidated financial statements. The discussion below addresses our continuing businesses.

Certain 2003 and 2002 period amounts presented below have been conformed to 2004 classifications, as a result of the divestiture of the OSB operations.

Year Ended December 31, 2004 Compared to Year Ended December 31, 2003

Consolidated net sales of \$1.35 billion for the year ended December 31, 2004, increased 13% compared to net sales of \$1.19 billion for the year ended December 31, 2003. Net sales increased for all segments in 2004. Resource segment net sales increased \$14.5 million to \$109.9 million, due largely to increased log sales to third parties and higher selling prices. Wood Products net sales increased 23% to \$439.0 million as a result of higher selling prices for lumber, plywood and particleboard products, as well as increased plywood shipments. Net sales for the Pulp and Paperboard segment increased \$43.5 million to \$482.6 million due to increased paperboard shipments, as well as higher selling prices for both pulp and paperboard. Consumer Products segment net sales increased to \$320.0 million from \$300.8 million due primarily to modestly higher selling prices and increased product shipments.

Expenses for depreciation, amortization and cost of fee timber harvested were \$88.3 million for the year ended December 31, 2004, a decrease of \$0.7 million from the prior year total of \$89.0 million.

For the year ended December 31, 2004, materials, labor and other operating expenses increased to \$1.08 billion from \$1.01 billion in 2003. The higher costs were due primarily to an increased volume of log sales to third parties and increased shipments of plywood, paperboard and consumer tissue products. Higher wood fiber costs for all segments and higher energy costs for the Consumer Products segment also contributed to the increase.

Selling, general and administrative expenses were \$85.6 million for the year ended December 31, 2004, compared to \$75.8 million for 2003. The higher expense was due primarily to increased corporate administration expense, higher research expense and higher selling expenses for the Consumer Products and Pulp and Paperboard segments.

The following items were included in the “Restructuring charges” line in the Statements of Operations:

- In the first quarter of 2003, we recorded \$0.2 million for additional costs related to the elimination of 106 salaried production and administrative positions in late 2002. The \$0.2 million was associated with employees whose service had been retained beyond the initial 60-day period following the announced job eliminations. In December 2003, we recorded a \$0.7 million credit, reflecting final cost determinations for pension and medical benefits. As of December 31, 2004, 102 employees had been terminated and four had assumed other positions within the company as a result of job openings.
- In January 2004, a pre-tax charge of \$1.3 million was recorded for a workforce reduction at our Consumer Products segment. A total of 60 production and 8 salaried employees were terminated. By June 2004, all costs had been incurred for the workforce reduction, resulting in a reversal to the initial charge of less than \$0.1 million.

Interest expense, net of capitalized interest, was \$45.9 million for the year ended December 31, 2004, \$2.3 million less than the \$48.2 million charged against income in 2003. The decrease was

Table of Contents

largely due to the redemption of \$244.5 million of our 10% Senior Subordinated Notes in October 2004, and \$27.0 million of our medium-term notes in November 2004.

In 2004, we incurred one-time, pre-tax costs of \$25.2 million for the early retirement of the senior subordinated notes and medium-term notes mentioned above. These debt retirement costs consisted of premium-related costs of \$44.7 million and recognized deferred debt issuance costs of \$4.9 million, partially offset by recognized interest rate swap settlements of \$24.4 million (see “Quantitative and Qualitative Disclosures About Market Risk” on pages 37-39 for further discussion of interest rate swaps). During 2003, we incurred one-time, pre-tax costs of \$0.2 million for the early retirement of \$3.1 million of outstanding debt.

Interest income for the year ended December 31, 2004, was \$3.6 million, compared to \$14.1 million for 2003. The 2003 amount consisted primarily of the receipt of \$13.2 million of interest income in conjunction with a settlement with the Internal Revenue Service for tax years 1989 through 1994.

For the year ended December 31, 2004, we recorded an income tax provision of \$10.0 million on income from continuing operations, based on an estimated effective tax rate of 39.4%. For the year ended December 31, 2003, we recorded an income tax benefit of \$9.1 million on our loss from continuing operations. During the third quarter of 2003, the tax rate of 39% that had been used for the first half of the year was revised to 34% to reflect our ability to apply anticipated tax credits to our 2003 tax provision. The revised rate resulted in an overall tax provision for 2003 of \$25.7 million. In allocating the \$25.7 million tax provision between continuing operations and discontinued operations for presentation in the 2003 statement of operations, the benefit from the anticipated tax credits was allocated to continuing operations, resulting in a tax benefit of \$9.1 million. A tax rate of 39% was applied to income from discontinued operations in 2003, resulting in a tax provision of \$34.9 million.

We recorded earnings from continuing operations of \$15.3 million for the year ended December 31, 2004, compared to a loss from continuing operations of \$3.8 million for 2003. Improved earnings in the Wood Products and Pulp and Paperboard segments more than offset a decline in Consumer Products segment results.

For the year ended December 31, 2004, we recorded after-tax earnings from discontinued operations of \$255.9 million, compared to after-tax earnings of \$54.6 million in 2003. The 2004 amount consisted of \$92.8 million of after-tax earnings from the OSB operations prior to the sale to Ainsworth Lumber Co. Ltd., and an after-tax gain on the sale of the OSB operations of \$163.1 million recorded in September 2004. The earnings from discontinued operations in 2003 of \$54.6 million were attributable to earnings from the OSB operations, partially offset by an after-tax loss of \$2.5 million related to our former printing papers mill in Brainerd, Minnesota, which was sold in February 2003. Net sales for discontinued operations for 2004 and 2003 were \$325.9 million and \$314.2 million, respectively.

Our net earnings, including discontinued operations, for 2004 were \$271.2 million, compared to earnings of \$50.7 million in 2003. Earnings improvements for our continuing operations and discontinued operations, as well as the gain on the sale of discontinued operations, were responsible for the favorable comparison.

Items recorded in “Other comprehensive gain (loss), net of tax” for 2004 included a \$32.2 million, after-tax decrease in our minimum pension liability and a net derivative loss due to cash flow hedges of \$0.1 million, after tax. The decrease in the minimum pension liability was the result of a \$57.9 million contribution to our pension plans in 2004 and market increases in our pension assets, despite a change in the discount rate from 6.25% to 5.90%. In 2003, we recorded a minimum pension liability increase totaling \$0.4 million, after tax, due primarily to a change in the discount rate from 6.75% to 6.25%, which was partially offset by market increases in our pension assets.

Discussion of business segments

See Note 14, "Segment Information," on pages 62-64 for tabular presentation of required business segment information for the years ended December 31, 2004, 2003 and 2002.

The Resource segment reported operating income of \$69.9 million for the year ended December 31, 2004, an increase of \$4.4 million from the \$65.5 million reported in 2003. Compared to 2003, increased log sales in 2004 to third parties in Idaho more than offset lower income from land sales. Segment net sales increased to \$274.3 million, compared to \$252.6 million in 2003. Increased log sales to third parties in Idaho during 2004 were largely responsible for the improvement. Revenue from sales of non-strategic land was \$22.7 million in 2004, compared to \$26.5 million in 2003. Conservation easement revenue of \$4.1 million was included in the total land sales revenues for 2004, while \$0.5 million was included in the 2003 figure. Income from sales of non-strategic land was \$20.8 million, or 30% of the Resource segment operating income for 2004, compared with \$24.8 million, or 38% of Resource operating income in 2003. The higher amount of land sales in 2003 was due primarily to the sale of 15,300 acres of non-strategic hardwood timberland in Arkansas. This sale of a large parcel was historically unusual, as most sales consist of small parcels of less than 500 acres each. The sale occurred because the buyer placed greater value on the large parcel of hardwood timberland than we did, as it was no longer strategic for future use in our business due to the fact we had previously sold our hardwood lumber mill in Arkansas and exited the hardwood lumber business. Land sale revenue amounts can and usually do vary between reporting periods, sometimes significantly, as was the case in 2003. The period-to-period fluctuations are due to the unique characteristics of each transaction such as location, size, accessibility, parcel attributes and the value to certain buyers. The sale of timberland is just one aspect of managing our timber and timberland assets to maximize shareholder value within this segment. No long-term pattern or trends should be associated with the land sales portion of the segment's operating activities. Intersegment sales increased \$7.2 million to \$164.4 million. Expenses for the Resource segment were \$204.4 million in 2004, compared to \$187.1 million recorded in 2003, reflecting the higher log sales volume in Idaho, an increase in the cost of log purchases from third parties and increased logging costs. Land sales generally do not have a material effect on segment expenses due to the low cost basis on most of our timberland.

The Wood Products segment's operating income of \$68.3 million for the year ended December 31, 2004, was a significant improvement over its operating income of \$4.1 million in 2003. Net sales for the segment were \$451.0 million, 22% higher compared to \$368.9 million reported in 2003. Wood products markets throughout much of 2004 benefited from continued strong homebuilding activity, as well as a weaker U.S. dollar. Lumber net sales increased to \$345.8 million in 2004, compared to \$279.2 million in 2003, due to a 25% increase in selling prices. Shipments of lumber products were slightly lower than the prior year due to downtime taken during 2004 at our Warren and Prescott, Arkansas, lumber facilities because of log shortages attributable to exceptionally wet conditions that curtailed logging operations. Plywood net sales increased to \$59.6 million for 2004, compared to \$46.4 million for 2003. Shipment volume increased 5% and sales prices were 22% higher than in 2003. Plywood shipments were 2% higher than production for 2004 and resulted in a decrease in inventory levels. In 2004, as in 2003, the plywood facility adjusted its product mix and temporarily operated some additional shifts to take advantage of strong market conditions during 2004. Particleboard shipments decreased 10% in 2004, due to a change in product mix and to downtime taken in late November and early December of 2004 to align inventory volumes with market conditions. Net sales of particleboard were \$18.7 million in 2004, compared to \$15.2 million in 2003. The increase was due to a 36% increase in selling prices. Expenses were \$382.7 million for the segment in 2004, compared to \$364.8 million in 2003. Increased plywood shipments and higher wood fiber costs accounted for the increase over 2003.

The Pulp and Paperboard segment reported operating income of \$11.0 million in 2004, versus a loss of \$15.1 million in 2003. Segment net sales increased to \$529.3 million for 2004, compared to

Table of Contents

\$482.0 million in 2003. Paperboard net sales were \$463.6 million in 2004, compared to \$420.8 million in 2003. Paperboard shipments increased 9% compared to 2003, as a result of increased production at the segment's two facilities in Idaho and Arkansas. Selling prices were slightly higher than 2003 as a result of an improved product mix and a weaker U.S. dollar. Pulp sales (including intersegment sales) were higher in 2004, totaling \$65.7 million for 2004, compared to \$61.2 million for 2003. The increase in pulp sales was due to 16% higher selling prices. Segment expenses for 2004 totaled \$518.3 million, compared to \$497.1 million in 2003. The increase reflected greater volumes of paperboard shipments in 2004 compared to 2003, higher wood fiber costs and higher maintenance expense due to downtime taken at both of the segment's facilities during the fourth quarter of 2004. These factors were partially offset by lower per ton costs resulting from improved production. Operating income for 2004 included \$3.0 million received from the bankruptcy liquidation of Beloit Corporation, a former vendor. The entire amount was recorded as income due to the write-off in 2001 of our claim against the Beloit bankruptcy estate.

The Consumer Products segment incurred an operating loss of \$10.2 million in 2004, compared to operating income of \$1.3 million in 2003. Market conditions remained very competitive for consumer tissue products throughout 2004. Segment net sales were \$320.1 million for 2004, 6% higher than the \$300.9 million recorded for 2003. The increase in net sales was due to a slight increase in product shipments combined with 4% higher selling prices. Shipments and prices in 2004 were positively affected by the rollout of our through-air-dried towel product. Segment expenses were \$330.2 million in 2004, compared to \$299.6 million in 2003. Increased product shipments and start-up costs related to the new tissue machine in Las Vegas contributed to the increase. Also, increased production costs due to higher pulp, freight, energy and labor costs adversely affected segment expenses. In addition, the segment recorded a pre-tax charge of \$1.2 million related to a workforce reduction early in 2004.

Year Ended December 31, 2003 Compared to Year Ended December 31, 2002

Net sales of \$1.19 billion for the year ended December 31, 2003, increased 8% compared to net sales of \$1.11 billion recorded for the year ended December 31, 2002. Increases in net sales for the Wood Products, Pulp and Paperboard and Resource segments of \$47.7 million, \$30.5 million and \$22.7 million, respectively, more than offset a decline in Consumer Products net sales of \$14.8 million. Increased shipments for lumber and plywood in the Wood Products segment and increased paperboard shipments in the Pulp and Paperboard segment in 2003 were largely responsible for the increase in net sales for these segments. The Resource segment net sales were higher due to increased land sales. A decrease in sales prices resulted in lower net sales for the Consumer Products segment.

Expenses for depreciation, amortization and cost of fee timber harvested were \$89.0 million for the year ended December 31, 2003, a decrease of \$9.0 million from the prior year total of \$98.0 million. For the year ended December 31, 2003, the major components constituting the decrease in depreciation, amortization and the cost of fee timber harvested were permit timber harvest expenses, which were \$4.4 million lower in Minnesota than in the prior year, and depreciation expense, which was \$1.7 million lower in the Pulp and Paperboard segment.

For the year ended December 31, 2003, materials, labor and other operating expenses rose to \$1.01 billion from \$0.92 billion in 2002. The higher costs were due primarily to increased shipments of lumber and paperboard.

Selling, general and administrative expenses were \$75.8 million for the year ended December 31, 2003, an increase from 2002's expense of \$72.1 million, due principally to an increase in selling expense.

Table of Contents

The following items were included in the "Restructuring charges" line in the Statements of Operations:

- In 2002, we recorded a \$9.0 million pre-tax charge for costs associated with the elimination of 106 salaried production and administrative positions. As of December 31, 2002, 82 employees had been terminated, three had assumed other positions within the company as a result of job openings and 21 were scheduled for termination in the first half of 2003.
- In the first quarter of 2003, we recorded additional charges totaling \$0.2 million for costs related to terminated employees whose service had been retained beyond the initial 60-day period following the announced job eliminations in 2002. In December 2003 we recorded a \$0.7 million credit, reflecting final cost determinations for pension and medical benefits. As of December 31, 2003, 100 employees had been terminated, four had assumed other positions within the company as a result of job openings and two individuals had been retained until mid-2004. As of December 31, 2003, all costs associated with the salaried workforce reduction had been incurred except immaterial amounts related to the retained individuals.

Interest expense, net of capitalized interest, was \$48.2 million for the year ended December 31, 2003, substantially less compared to the \$59.9 million charged against income in 2002. The decrease reflected the lower amount of average debt outstanding during 2003 compared to 2002, as well as an increase of \$2.6 million in the amount of interest capitalized from major construction projects in 2003 versus 2002. Capitalized interest increased in 2003 due to the construction of a new tissue machine in Las Vegas, Nevada. It is our policy to calculate and capitalize interest on capital projects with a construction period exceeding 12 months, based upon management's discretion in consideration of the requirements of SFAS No. 34, "Capitalization of Interest Costs." These factors were partially offset by increased interest expense of approximately \$2.8 million on our \$100 million credit sensitive debentures, due to the lowering of our debt ratings in January 2003.

In 2003, we incurred one-time, pre-tax costs of \$0.2 million for the early retirement of \$3.1 million of outstanding debt. During 2002, we incurred one-time, pre-tax costs of \$15.4 million related to our early retirement of over \$380 million of outstanding debt.

Interest income for the year ended December 31, 2003, was \$14.1 million, compared to \$1.9 million recorded in 2002. The increase was primarily due to the receipt of \$13.2 million of interest income in conjunction with a settlement with the Internal Revenue Service for tax years 1989 through 1994.

For the year ended December 31, 2003, we recorded an income tax benefit of \$9.1 million on our loss from continuing operations. During the third quarter of 2003, the tax rate of 39% that had been used for the first half of the year was revised to 34% to reflect our ability to apply anticipated tax credits to our 2003 tax provision. The revised rate resulted in an overall tax provision for 2003 of \$25.7 million. In allocating the \$25.7 million tax provision between continuing operations and discontinued operations for presentation in the 2003 statement of operations, the benefit from the anticipated tax credits was allocated to continuing operations, resulting in a tax benefit of \$9.1 million. A tax rate of 39% was applied to income from discontinued operations in 2003, resulting in a tax provision of \$34.9 million. For the year ended December 31, 2002, we recorded an income tax benefit of \$26.4 million, reflecting our net loss from continuing operations before taxes, based on an estimated effective tax rate of 39%.

We recorded a loss from continuing operations for the year ended December 31, 2003 of \$3.8 million, compared to a loss from continuing operations of \$41.2 million for the year ended December 31, 2002.

Table of Contents

We recorded after-tax earnings from our discontinued operations of \$54.6 million in 2003, compared to an after-tax loss of \$193.2 million in 2002. Discontinued operations included our OSB operations, our former Printing Papers segment and a hardwood sawmill. The earnings from discontinued operations in 2003 were attributable to income from the OSB operations, partially offset by costs related to our former printing papers mill in Brainerd, Minnesota, which was sold in February 2003. Included in the 2002 amount was \$168.5 million for loss on disposition of our former Printing Papers segment and \$24.7 million in operational losses, primarily from the printing papers and OSB operations.

Our net earnings, including discontinued operations, for 2003 were \$50.7 million, compared to a net loss of \$234.4 million in 2002.

Items recorded in "Other comprehensive loss, net of tax" for 2003 included a \$0.4 million, after-tax increase to our minimum pension liability, partially offset by cash flow hedge derivative gains of \$0.1 million, after tax, related to our natural gas hedging activities. The increase to the minimum pension liability was the result of a change in the discount rate from 6.75% to 6.25%, partially offset by market increases in our pension assets. In 2002, we recorded a minimum pension liability increase totaling \$33.2 million, after tax, as a result of market declines in our pension assets and a reduction in the discount rate from 7.25% to 6.75%.

Discussion of business segments

The Resource segment reported operating income of \$65.5 million for the year ended December 31, 2003, slightly higher than the \$62.6 million reported in 2002. Higher income from land sales in 2003 offset lower earnings from wood fiber sales. In 2003, income from land sales was 38% of the Resource segment operating income due primarily to the sale of 15,300 acres of non-strategic hardwood timberland in Arkansas. Income from land sales in 2002 was 11% of segment operating income. As was mentioned previously on page 28, land sale revenue amounts can and usually do vary between reporting periods, sometimes significantly as was the case in 2003. No long-term pattern or trends should be associated with the land sales portion of the segment's operating activities. Segment net sales decreased to \$252.6 million in 2003, compared to \$411.8 million in 2002. The decrease in net sales in 2003 was due to decreased wood fiber sales to our Wood Products and Pulp and Paperboard operating segments in Arkansas, Idaho and Minnesota. In the third quarter of 2002, these operating segments began the transition to a fiber procurement system whereby portions of third party fiber purchases are made directly by each segment. The changes in the fiber procurement system resulted in lower intersegment sales for the Resource segment and, consequently, lower wood fiber purchases by the Resource segment from third parties. Intersegment sales declined \$181.9 million in 2003 compared to 2002. Increased land sales partially offset the decline in wood fiber sales in 2003. Land sales revenue totaled \$26.5 million in 2003 compared to \$7.3 million in 2002. Expenses for the Resource segment were \$187.1 million in 2003, significantly lower than the \$349.3 million recorded in 2002, due to reduced outside wood purchases by the Resource segment.

The Wood Products segment's operating income of \$4.1 million for the year ended December 31, 2003, was a significant improvement over the operating loss of \$11.1 million incurred in 2002. Net sales for the segment were \$368.9 million, compared to \$321.9 million reported in 2002. Low interest rates during 2003 helped to sustain a high level of new home construction, and by mid-year lumber and panel inventory levels began to recover from their previously oversupplied position, with a corresponding rise in sales prices. The effect was particularly favorable for plywood. Our plywood facility in Idaho adjusted its product mix and temporarily operated some additional shifts during 2003 to take advantage of market conditions. The resulting added production allowed a 27% increase in shipments, and, combined with increased sales prices, accounted for plywood net sales of \$46.4 million, a 33% increase compared to net sales of \$34.9 million in 2002. Lumber net sales

Table of Contents

increased to \$279.2 million in 2003, compared to \$249.8 million in 2002, due to a 17% increase in shipments, partially offset by a 5% decline in sales prices. The increase in shipments in 2003 was due to higher production at our lumber mills, largely as a result of adding a shift at each of our Arkansas facilities. Particleboard shipments increased 14% in 2003, due to the absence of market-related downtime taken in 2002. Net sales of particleboard were \$15.2 million in 2003, compared to \$14.1 million in 2002. Expenses were \$364.8 million for the segment in 2003, compared to \$333.0 million in 2002. Higher product shipments were primarily responsible for the increase.

The Pulp and Paperboard segment incurred an operating loss of \$15.1 million in 2003, versus a loss of \$42.8 million in 2002. Segment net sales increased to \$482.0 million for 2003, compared to \$443.6 million in 2002. Paperboard net sales were \$420.8 million in 2003, compared to \$395.1 million in 2002. Paperboard shipments increased 9% compared to 2002, more than offsetting a 2% decline in sales prices. Pulp sales (including intersegment sales) were higher in 2003, rising to \$61.2 million, compared to \$48.5 million for 2002. The increase in pulp and paperboard sales in 2003 was due to higher production at our Lewiston, Idaho, facility, which allowed increased pulp shipments internally and increased paperboard and pulp shipments to external customers. Pulp sales prices to external customers increased 12% in 2003. Segment expenses for 2003 totaled \$497.1 million, compared to \$486.4 million in 2002. The increase reflected greater volumes of product shipments in 2003 compared to 2002, as well as higher energy and wood fiber costs at our McGehee, Arkansas, facility. However, increased paperboard and pulp production at the Lewiston facility resulted in lower unit production costs compared to 2002.

The Consumer Products segment reported operating income of \$1.3 million in 2003, significantly less than the \$42.8 million earned in 2002. Very competitive markets during the year resulted in a 5% decline in net sales, to \$300.9 million, compared to \$315.7 million in 2002. The effect of a sales price decline of 7% for 2003 was only partially offset by a 2% increase in product shipments. Segment expenses were \$299.6 million in 2003, compared to \$272.9 million in 2002. Higher per unit costs due to downtime taken on some converting lines during the year to reduce finished goods inventory levels, higher pulp costs, higher selling and administration costs in anticipation of the start-up of the new tissue machine in Las Vegas, and increased product shipments contributed to higher expenses in 2003.

Liquidity and Capital Resources

At December 31, 2004, our financial position included long-term debt of \$336.5 million, including current installments on long-term debt of \$1.1 million. Long-term debt at December 31, 2004 (including current installments) declined \$282.3 million from the December 2003 balance due to the redemption of \$244.5 million of our 10% Senior Subordinated Notes (due in July 2011), \$27.0 million in medium-term notes and \$10.3 million of revenue bonds, as well as normal payments on maturing debt of \$0.5 million. Maturity dates for the medium-term notes redeemed were 2011 and 2022. Of the \$10.3 million in revenue bonds redeemed in conjunction with the sale of our OSB operations, \$2.0 million were due 2005 through 2009 and the remaining \$8.3 million were due 2013. A portion of the proceeds from the sale of our OSB operations was used to redeem all of the notes and bonds mentioned above. Stockholders' equity increased \$200.5 million, largely due to net earnings of \$271.2 million, issuance of treasury stock totaling \$57.5 million and a \$32.1 million reduction in accumulated other comprehensive loss. These were partially offset by the repurchase of \$75.4 million in company stock through an accelerated stock repurchase program, a \$2.50 per common share special dividend totaling \$74.7 million and regular quarterly dividend payments totaling \$17.7 million. The ratio of long-term debt (including current installments) to stockholders' equity was 0.50 to 1 at December 31, 2004, compared to 1.31 to 1 at December 31, 2003.

Table of Contents

Scheduled payments due on long-term debt during each of the five years subsequent to December 31, 2004, are as follows:

(Dollars in thousands)

2005	\$ 1,107
2006	2,358
2007	6,159
2008	209
2009	100,410

Working capital totaled \$255.1 million at December 31, 2004, a decrease of \$48.7 million from December 31, 2003. The significant changes in the components of working capital are as follows:

- Short-term investments increased \$71.9 million. We invested positive cash flow from increased operating earnings and asset sales not immediately needed for operations or capital expenditures into short-term bank instruments. A portion of our short-term investments were used in the fourth quarter of 2004 for debt reduction, a stock repurchase program, dividends and to fund pension plans.
- Receivables increased \$12.4 million, primarily as a result of increased sales and the corresponding increase in customer receivables.
- Inventories increased \$26.7 million due primarily to increases in tissue parent roll and lumber inventories.
- Assets held for sale and related liabilities decreased to a zero balance from \$165.5 million at December 31, 2003, due to the sale of the OSB operations in September 2004.
- Accounts payable and accrued liabilities decreased \$7.0 million due primarily to lower accrued interest resulting from the repayment of \$282.3 million in debt.

Net cash used for continuing operations in 2004 totaled \$22.9 million, compared with cash provided by operations of \$65.1 million in 2003 and \$20.8 million in 2002. A \$57.9 million contribution to our two qualified hourly defined benefit pension plans in 2004, versus a \$19.5 million contribution in 2003, and cash used for working capital items in 2004, compared with cash generated from working capital changes in 2003, were responsible for the decrease. Net earnings from continuing operations in 2004, versus a net loss in 2003, partially offset the unfavorable comparison. The net earnings in 2004 were generally due to higher selling prices for wood products, pulp and paperboard, as well as increased paperboard shipments. The \$57.9 million pension contribution represented the maximum contribution allowed for tax deduction purposes and, assuming no significant drop in our discount rate assumption or asset return, should eliminate the requirement for any material contributions to the plans for the next several years. Cash generated from working capital changes in 2003, versus cash used for working capital items in 2002, accounted for a majority of the favorable comparison between 2003 and 2002.

Net cash used for investing was \$128.1 million in 2004, and \$108.3 million in 2003. Net cash provided by investing was \$49.7 million in 2002. In 2004 we used \$48.9 million for capital spending and \$71.9 million to increase our short-term investments. Capital spending in 2004 included \$5.2 million for the completion of our new tissue machine in Las Vegas, Nevada, and \$6.9 million towards the establishment of a tissue converting facility in Elwood, Illinois. The balance of capital spending in 2004 was focused on forest resources and various small projects designed to improve product quality and manufacturing efficiency. Cash was used in 2003 primarily for \$76.1 million of capital spending projects and for increasing short-term investments. The use of restricted cash in 2003 to repay debt partially offset these activities. Cash provided by investing in 2002 was due to decreases in restricted cash and short-term investments.

Table of Contents

At December 31, 2004, our authorized capital spending budget, including \$11.7 million carried over from prior years, totaled \$108.5 million. We expect to spend \$107.5 million of this amount in 2005. Spending in 2005 is expected to include the replacement of dry kilns at our lumber operation in Lewiston, Idaho, additional equipment and installation costs associated with our tissue converting facility in Elwood, Illinois, and various discretionary, high-return projects for our Wood Products, Pulp and Paperboard and Consumer Products segments. In addition, spending will include various routine general replacement and forest resource projects. Spending on projects may be postponed due to delays in the acquisition of environmental permits, acquisition of equipment, engineering, weather and other factors.

Net cash used for financing totaled \$432.6 million in 2004, compared to \$56.9 million in 2003 and \$495.3 million in 2002. The majority of cash used for financing in 2004 was to redeem \$282.3 million of long-term debt, repurchase \$75.4 million in company stock, pay a \$2.50 per common share special dividend totaling \$74.7 million and pay regular quarterly dividends totaling \$17.7 million. Cash provided by the issuance of \$57.5 million of treasury stock, related to the exercise of stock options, partially offset these activities. The majority of cash used for financing in 2003 was to repay \$40.0 million in borrowings under our bank credit facility, retire long-term debt of \$19.5 million and pay regular quarterly dividends of \$17.2 million. The majority of cash used for financing in 2002 was to retire \$511.9 million of long-term debt.

Cash generated from discontinued operations in 2004 totaled \$585.0 million, all of which was related to operating earnings and proceeds from the sale of the OSB operations. Discontinued operations in 2003 generated cash of \$98.2 million, which consisted of earnings from our OSB operations, combined with proceeds from the sale of our former printing papers mill in Brainerd, Minnesota.

On June 29, 2004, we entered into a new three-year unsecured bank credit facility, which replaced a secured bank credit facility that expired on June 28, 2004. The new credit facility provides a revolving line of credit of up to \$125 million, including a \$35 million subfacility for letters of credit and a \$10 million subfacility for swing line loans. Usage under either or both subfacilities reduces availability under the revolving line of credit. As of December 31, 2004, there were no borrowings outstanding under the revolving line of credit; however, approximately \$10.6 million of the letter of credit subfacility was being used to support several outstanding letters of credit.

In connection with the successful redemption of substantially all of the outstanding \$250 million senior subordinated notes in October 2004, we obtained sufficient consents from the note holders to remove from the indenture that governed these notes all restrictive covenants and all events of default, except for payment and bankruptcy defaults.

The agreement governing our unsecured bank credit facility contains certain covenants that, among other things, limits to a certain degree our ability and our subsidiaries' ability to create liens, merge or consolidate, dispose of assets, incur indebtedness and guarantees, pay dividends, repurchase or redeem capital stock and indebtedness, make certain investments or acquisitions, enter into certain transactions with affiliates or change the nature of our business. The unsecured bank credit facility also contains financial maintenance covenants establishing a maximum funded indebtedness to capitalization ratio, a minimum consolidated net worth requirement, and a minimum interest coverage ratio. Events of default under the unsecured bank credit facility include, but are not limited to, payment defaults, covenant defaults, breaches of representations and warranties, cross defaults to certain other material agreements and indebtedness, bankruptcy and other insolvency events, material adverse judgments, actual or asserted invalidity of security interests or loan documentation, and certain change of control events involving our company. The company received consent from the participating banks in our credit agreement to allow for the payment of the special

Table of Contents

dividend to shareholders and to implement the stock repurchase plan. As of December 31, 2004, we were in compliance with the covenants of our unsecured bank credit facility.

Although in 2003 and 2004 our OSB operations generated a significant portion of our operating income and cash flows, we believe that our cash, cash flows from continuing operations and available borrowings under our current unsecured bank credit facility will be sufficient to fund our operations, capital expenditures and debt service obligations for the next twelve months. The use of a portion of the proceeds from the OSB sale to reduce debt will improve future cash flows by reducing interest expense. We cannot assure, however, that our business will generate sufficient cash flow from operations or that we will be in compliance with the financial covenants in our unsecured bank credit facility so that future borrowings thereunder will be available to us. Thus, our ability to fund our operations will be dependent upon our future financial performance, which will be affected by general economic, competitive and other factors, including those discussed above under "Factors Influencing Our Results of Operations," many of which are beyond our control.

As of December 31, 2004, Standard & Poor's Ratings Services (S&P) rated our senior unsecured debt at BB+ with a stable outlook. The rating has remained unchanged since January 30, 2003. Since the first quarter of 2003, Fitch, Inc. has rated our senior unsecured debt at BB+. In October 2004, Fitch reaffirmed this rating and removed the company from its Ratings Watch Evolving list. In October 2004, Moody's Investors Service Inc. downgraded its rating of our senior unsecured debt from Baa3 with a negative outlook to Ba1 with a stable outlook. Moody's also downgraded our senior secured subordinated rating from Ba1 to Ba2. The interest rate we pay on some of our debt is influenced by our credit ratings. See "Quantitative and Qualitative Disclosures About Market Risk" on pages 37-39 for additional information.

The following table summarizes our contractual obligations as of December 31, 2004. Portions of the amounts shown are reflected in our consolidated financial statements and accompanying notes, as required by generally accepted accounting principles. See the footnotes following the table for information regarding the amounts presented and for references to appropriate consolidated financial statement notes, which include a detailed discussion of the item.

	Payments due by period				
	Total	1 Year	2-3 Years	4-5 Years	Over 5 Years
	(Dollars in thousands)				
Long-term debt (1)	\$336,522	\$ 1,107	\$ 8,517	\$100,619	\$226,279
Operating leases (2)	78,885	12,039	20,211	14,786	31,849
Purchase obligations	118,470	106,319	11,201	950	—
Other long-term obligations (3)	234,311	24,209	51,226	56,361	102,515
Total	\$768,188	\$143,674	\$91,155	\$172,716	\$360,643

(1) See Note 7, Debt, in the notes to consolidated financial statements.

(2) See Note 12, Commitments and Contingencies, in the notes to consolidated financial statements.

(3) Payments on qualified pension plans are based on estimated minimum required contributions for years 1-5. Payments on postretirement benefit plans are based on expected future benefit payments as disclosed in Note 11 to the consolidated financial statements for years 1-5.

In October 2004, the Board of Directors authorized the repurchase of approximately \$75 million of company stock through an accelerated stock repurchase program with a financial counterparty. In conjunction with this agreement, 1,560,397 shares were acquired in the fourth quarter of 2004 at a cost of \$75.4 million subject to adjustment described below under "Quantitative and Qualitative

Table of Contents

Disclosures About Market Risk.” The Board authorization for this stock repurchase superseded a previous authorization to repurchase up to 2 million shares announced in December 1999, under which authorization 910,900 shares were repurchased. We do not expect to repurchase additional common stock in the near future.

It is our practice to periodically review strategic and operational alternatives to improve our operating results and financial position. In this regard, we consider and plan to continue to consider, among other things, adjustments to our capital expenditures and overall spending, the restructuring of our operations to achieve greater efficiencies, and the disposition of assets that may have greater value to others. In addition, in September 2004, we announced that our Board of Directors is continuing to study the possibility of expanding or restructuring existing core businesses or converting to a real estate investment trust. There can be no assurance that we will be successful in implementing any new strategic or operational initiatives or, if implemented, that they will have the effect of improving our operating results and financial position.

Off-Balance Sheet Arrangements

We currently are not a party to off-balance sheet arrangements that would require disclosure under this section.

Environment

We are subject to extensive federal and state environmental regulations at our operating facilities and timberlands, particularly with respect to air emissions, wastewater discharges, solid and hazardous waste management, site remediation, forestry operations and endangered species. We endeavor to comply with all environmental regulations and regularly monitor our activities for such compliance. Compliance with environmental regulations is a significant factor in our business and requires capital expenditures as well as additional operating costs. Capital expenditures specifically designated for environmental compliance totaled approximately \$0.4 million during 2004 and are expected to be approximately \$3 million in 2005.

As previously discussed in Item I, Business, our timberlands in Idaho, Arkansas and Minnesota are certified by independent third parties to be in compliance with the SFI Program and the ISO 14001 standard for environmental management systems. Our Idaho timberlands are also certified under the FSC standards. Participation in the SFI, ISO and FSC programs is voluntary, and can require operating processes which are more stringent than existing federal or state requirements.

In early 1998 the Environmental Protection Agency (EPA) published the “Cluster Rule” regulations specifically applicable to the pulp and paper industry. These extensive regulations govern both air and water emissions. During 2001, we completed modifications to process equipment and operating procedures to comply with Phase I of the regulations. Phase II of the regulations relates to control of high volume, low concentration emissions at kraft pulp mills, and our compliance efforts are scheduled to be completed in 2006 at an expected remaining cost of approximately \$2 million. We do not expect that such compliance costs will have a material adverse effect on our competitive position.

Our pulp mill at Lewiston, Idaho, discharges treated mill effluent into the nearby Snake River. Federal law requires that we comply with provisions of a National Pollution Discharge Elimination System (NPDES) permit. As allowed by federal regulations, we are operating under an NPDES permit that expired in 1997, but which continues to be in force until the effective date of a new NPDES permit. The EPA published a revised draft NPDES permit in June 2003, which among other matters requires a significant reduction in biochemical oxygen demand over the five year period of the new permit and also requires within two years of the effective date of the new permit a reduction in the

Table of Contents

temperature of the effluent during the months of July, August and September each year. Meeting these requirements would require modifications of operating practices that will increase operating costs. Physical modifications to the effluent system over the next several years may be required at an estimated cost of up to \$1.8 million. We do not expect that such compliance costs will have a material adverse effect on our competitive position.

The EPA has developed Maximum Achievable Control Technology (MACT) standards for pulp and paper facilities, plywood and composite wood facilities and certain boiler units. We have studied the applicable MACT standards, and we estimate that capital expenditures necessary for compliance will be minimal. Compliance deadlines are in 2006 and 2007.

We believe that our facilities are currently in substantial compliance with applicable environmental laws and regulations. We cannot assure, however, that situations that may give rise to material environmental liabilities will not be discovered or that the enactment of new environmental laws or regulations or changes in existing laws or regulations will not require significant expenditures by us.

In late January 2004, we voluntarily reported to the Minnesota Pollution Control Agency (MPCA) a potential air permit violation at our former oriented strand board facility in Bemidji, Minnesota (sold in September 2004), relating to the non-operation of equipment used to control nitrous oxide emissions from a wood-fired boiler for a period of approximately 29 months. Corrective action was taken, and we have cooperated with the MPCA in its investigation. The MPCA has completed its investigation, and we and the MPCA are discussing a proposed settlement agreement, including the amount of a proposed penalty, which we believe will be less than \$1 million. We have established a reserve in accordance with SFAS No. 5.

Taking into consideration the amount of the proposed penalty to be assessed in the above described matter, we believe there is no pending or threatened litigation that would have a material adverse effect on our financial position, operations or liquidity.

Income Taxes

Our effective tax rate for 2004 was 39.4%, compared to 34% for 2003 and 39% for 2002. The effective rate for 2003 was lower than the rates used for 2004 and 2002 as a result of applying tax credits to our 2003 tax provision.

Quantitative and Qualitative Disclosures About Market Risk

Our exposure to market risks on financial instruments includes interest rate risk on our short-term investments, unsecured bank credit facility and long-term debt, credit rate risk on our credit sensitive debentures and equity price risk related to our accelerated stock repurchase program.

Our short-term investments are invested in money market funds and bonds with very short maturity periods and they therefore earn an interest rate commensurate with low-risk instruments. We do not attempt to hedge our exposure to interest rate risk for our short-term investments.

As of December 31, 2004, we had no borrowings outstanding under our unsecured bank credit facility. The interest rates applied to borrowings under the unsecured bank credit facility are adjusted often and therefore react quickly to any movement in the general trend of market interest rates. We do not attempt to mitigate the effects of short-term interest rate fluctuations on our unsecured bank credit facility borrowings through the use of derivative financial instruments.

All of our long-term debt is fixed-rate and therefore changes in market interest rates do not expose us to interest rate risk for these financial instruments. From December 2001 to August 2004,

Table of Contents

we entered into several fixed-to-variable interest rate swaps to hedge a portion of our 10% Senior Subordinated Notes. The swaps were designated as fair value hedges and called for the company to pay a variable interest amount, based on LIBOR rates, and receive a fixed-rate payment from a financial institution, calculated on \$165.0 million of our 10% Senior Subordinated Notes. The terms of the interest rate swaps allowed us to assume there was no ineffectiveness in the hedges, and therefore, no amounts representing ineffectiveness were recognized in earnings during the periods the swaps were in effect. In August 2004, we terminated the last of these swaps. The aggregate cash settlements received upon termination of the swaps totaled \$29.2 million, of which \$4.3 million has been ratably accreted to earnings over the term of the underlying debt. In October 2004, as a result of our early repayment of \$244.5 million of the notes, we recognized in earnings \$24.4 million of the aggregate cash settlements received. The balance of the cash settlements, totaling \$0.5 million at December 31, 2004, is being accreted to earnings until the remaining \$5.5 million of outstanding notes mature or are redeemed. We have the right to call the notes for redemption beginning July 15, 2006.

We currently have \$100 million of credit sensitive debentures outstanding that pay interest to the debt holder based upon our credit ratings as established by S&P or Moody's. The following table denotes the interest rate applicable based on various credit ratings:

Ratings		Applicable Rate(%)
Moody's	S&P	
Aaa	AAA	8.825
Aa1 – Aa3	AA+ – AA –	8.925
A1 – Baa2	A+ – BBB	9.125
Baa3	BBB –	9.425
Ba1	BB+	12.500
Ba2	BB	13.000
Ba3	BB –	13.500
B1 or lower	B+ or lower	14.000

On January 30, 2003, S&P announced that it had lowered our senior unsecured debt rating to BB+ from BBB –. The rating downgrade caused the interest rate on our credit sensitive debentures to increase from 9.425% to 12.5%, effective January 30, 2003. On October 11, 2004, Moody's announced that it had lowered the rating on our senior unsecured debt to Ba1 from Baa3. Because S&P's rating was already at that level, the change had no effect on the interest rate for the credit sensitive debentures.

During the third quarter of 2003, we entered into several derivative financial instruments designated as cash flow hedges for a portion of our natural gas purchases during November 2003 through March 2004. As designated cash flow hedges, changes in the fair value of the financial instruments were recognized in "Other comprehensive loss, net of tax" to the extent the hedges were deemed effective, until the hedged item was recognized in the statement of operations. As of March 31, 2004, the derivative financial instruments entered into in the third quarter of 2003 had expired, and we have not entered into any additional instruments to hedge our expected future natural gas purchases.

In October 2004, our board of directors authorized the repurchase of approximately \$75 million of our outstanding common stock, to be implemented through an accelerated stock repurchase program with a financial counterparty. In November, we repurchased 1,560,397 shares for \$75.4 million, or approximately \$48.29 per share, subject to adjustment as described below. In connection with the repurchase, the counterparty will purchase shares for its own account in the open market over a nine-month period ending in August 2005. At the end of that period, we will receive or pay a price adjustment based on the volume weighted average price of shares traded during the period.

Table of Contents

Approximately 808,900 of the shares purchased through the accelerated stock repurchase program are subject to a collar, which sets a minimum and maximum price for shares repurchased, for the purpose of limiting the price adjustment. For the shares subject to the collar, the maximum price adjustment we would receive is equal to \$187,500, or \$.23 per share, and the maximum price adjustment we would pay is equal to \$1,875,000, or \$2.32 per share. The price adjustment for the remainder of the shares is not subject to any limitation. Any obligation we may have under the stock repurchase program may be settled by the issuance of company stock or a cash payment at our discretion.

QUANTITATIVE INFORMATION ABOUT MARKET RISKS

(Dollars in thousands — except share and per-share amounts)

	Expected Maturity Date					
	2005	2006	2007	2008	2009	Thereafter
Long-term debt:						
Fixed rate	\$1,107	\$2,358	\$6,159	\$209	\$100,410	\$226,279
Average interest rate	6.1%	6.3%	6.1%	6.9%	12.5%	7.0%
Fair value at 12/31/04						\$377,534
						Maturity-2005
Accelerated stock repurchase transaction:						
Collared contract volume (shares)						808,894
Capped settlement amount						\$ 1,875
Floor settlement amount						188
Forward price (per share)						\$ 46.36
Shares purchased by counterparty through 12/31/04 subject to collar						143,998
Uncollared contract volume (shares)						751,503
Initial trade price						\$ 49.90
Shares purchased by counterparty through 12/31/04 not subject to collar						133,782
Average price of repurchased shares through 12/31/04						\$ 49.92

POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
(Dollars in thousands — except per-share amounts)

	For the years ended December 31		
	2004	2003	2002
Net sales	\$1,351,472	\$1,192,437	\$1,106,306
Costs and expenses:			
Depreciation, amortization and cost of fee timber harvested	88,319	88,987	97,986
Materials, labor and other operating expenses	1,083,660	1,006,786	921,576
Selling, general and administrative expenses	85,571	75,800	72,053
Restructuring charges (Note 15)	1,193	(476)	8,963
	<u>1,258,743</u>	<u>1,171,097</u>	<u>1,100,578</u>
Earnings from operations	92,729	21,340	5,728
Interest expense, net of capitalized interest of \$383 (\$2,907 in 2003 and \$300 in 2002)	(45,863)	(48,172)	(59,882)
Debt retirement costs	(25,186)	(248)	(15,360)
Interest income	3,617	14,090	1,939
	<u>25,297</u>	<u>(12,990)</u>	<u>(67,575)</u>
Earnings (loss) before taxes	25,297	(12,990)	(67,575)
Provision (benefit) for taxes (Note 6)	9,967	(9,148)	(26,354)
	<u>15,330</u>	<u>(3,842)</u>	<u>(41,221)</u>
Earnings (loss) from continuing operations	15,330	(3,842)	(41,221)
Discontinued operations (Note 16):			
Earnings (loss) from discontinued operations (including gain (loss) on disposal of \$269,587, \$(2,745) and \$(276,218))	422,017	89,456	(316,656)
Income tax provision (benefit)	166,098	34,887	(123,496)
	<u>255,919</u>	<u>54,569</u>	<u>(193,160)</u>
Net earnings (loss)	<u>\$ 271,249</u>	<u>\$ 50,727</u>	<u>\$ (234,381)</u>
Other comprehensive gain (loss), net of tax:			
Cash flow hedges:			
Net derivative gains (losses), net of income tax provision (benefit) of \$(44), \$44 and \$0	(68)	68	—
Minimum pension liability adjustment, net of income tax provision (benefit) of \$20,554, \$(239) and \$(21,231)	32,178	(374)	(33,207)
	<u>\$ 303,359</u>	<u>\$ 50,421</u>	<u>\$ (267,588)</u>
Comprehensive income (loss)	303,359	50,421	(267,588)
Earnings (loss) per common share from continuing operations:			
Basic	\$ 0.52	\$ (.13)	\$ (1.45)
Diluted	0.52	(.13)	(1.45)
Earnings (loss) per common share from discontinued operations:			
Basic	8.71	1.90	(6.78)
Diluted	8.67	1.90	(6.78)
Net earnings (loss) per common share:			
Basic	9.23	1.77	(8.23)
Diluted	9.19	1.77	(8.23)

Certain amounts for 2003 and 2002 have been reclassified to conform to the 2004 presentation as a result of the divestiture of the OSB operations.

The accompanying notes and summary of principal accounting policies are

an integral part of these consolidated financial statements.

POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(Dollars in thousands — except per-share amounts)

	At December 31	
	2004	2003
ASSETS		
Current assets:		
Cash (Note 10)	\$ 8,646	\$ 7,190
Short-term investments (Note 10)	111,975	40,091
Receivables, net of allowance for doubtful accounts of \$1,226 (\$1,135 in 2003)	103,474	91,050
Inventories (Note 2)	167,015	140,351
Prepaid expenses (Note 6)	16,260	18,315
Assets held for sale (Note 16)	—	176,596
Total current assets	407,370	473,593
Land, other than timberlands	8,351	7,850
Plant and equipment, at cost less accumulated depreciation of \$1,195,376 (\$1,136,245 in 2003) (Note 3)	567,471	600,964
Timber, timberlands and related logging facilities, net (Note 4)	401,078	396,482
Other assets (Note 5)	210,402	118,488
	<u>\$1,594,672</u>	<u>\$1,597,377</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current installments on long-term debt (Notes 7 and 10)	\$ 1,107	\$ 507
Accounts payable and accrued liabilities (Note 8)	151,198	158,185
Liabilities related to assets held for sale (Note 16)	—	11,125
Total current liabilities	152,305	169,817
Long-term debt (Notes 7 and 10)	335,415	618,278
Other long-term obligations (Note 9)	234,311	266,514
Deferred taxes (Note 6)	201,252	71,917
Stockholders' equity:		
Preferred stock, Authorized 4,000,000 shares	—	—
Common stock, \$1 par value, Authorized 40,000,000 shares, Issued 32,721,980 shares	32,722	32,722
Additional paid-in capital	147,851	130,996
Retained earnings	622,025	443,202
Accumulated other comprehensive loss:		
Minimum pension liability adjustment	(1,403)	(33,581)
Cash flow hedges	—	68
Common shares in treasury 3,802,004 (3,881,217 in 2003)	(129,806)	(102,556)
Total stockholders' equity	<u>671,389</u>	<u>470,851</u>
	<u>\$1,594,672</u>	<u>\$1,597,377</u>

Certain amounts for 2003 have been reclassified to conform to the 2004 presentation as a result of the divestiture of the OSB operations.

The accompanying notes and summary of principal accounting policies are an integral part of these consolidated financial statements.

POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

	For the years ended December 31		
	2004	2003	2002
CASH FLOWS FROM CONTINUING OPERATIONS			
Net earnings (loss)	\$ 271,249	\$ 50,727	\$ (234,381)
Adjustments to reconcile net earnings (loss) to net operating cash flows:			
Loss (earnings) from discontinued operations	(92,819)	(56,243)	24,668
Loss (gain) on disposal of discontinued operations	(163,100)	60	168,493
Depreciation, amortization and cost of fee timber harvested	88,319	88,987	97,986
Debt retirement costs	25,186	248	15,360
Deferred taxes	30,289	(19,384)	(9,229)
Employee benefit plans	(4,350)	1,514	3,295
Decrease (increase) in receivables	(12,424)	19,502	(1,457)
Decrease (increase) in inventories	(26,664)	2,567	(48,575)
Decrease (increase) in prepaid expenses	2,055	20,690	(7,897)
Increase (decrease) in accounts payable and accrued liabilities	(89,010)	(24,087)	12,513
Income tax benefit resulting from the exercise of employee stock options	6,225	—	—
Funding of qualified pension plans	(57,853)	(19,461)	—
Net cash provided by (used for) continuing operations	(22,897)	65,120	20,776
CASH FLOWS FROM INVESTING			
Decrease in restricted cash	—	15,069	83,131
Decrease (increase) in short-term investments	(71,884)	(38,091)	28,500
Additions to plant and equipment, and to land other than timberlands	(35,285)	(61,395)	(34,266)
Additions to timber, timberlands and related logging facilities	(13,615)	(14,695)	(14,658)
Disposition of plant and properties	942	714	2,621
Other, net	(8,243)	(9,853)	(15,642)
Net cash provided by (used for) investing	(128,085)	(108,251)	49,686
CASH FLOWS FROM FINANCING			
Change in book overdrafts	(5,582)	4,610	(9,952)
Increase (decrease) in notes payable	—	(40,000)	40,000
Retirement of long-term debt	(282,263)	(19,467)	(511,873)
Premiums and fees on debt retirement	(44,686)	(248)	(10,584)
Issuance of treasury stock	57,547	6,799	8,146
Purchase of treasury stock	(75,352)	—	—
Dividends on common stock	(92,426)	(17,217)	(17,071)
Other, net	10,160	8,656	6,054
Net cash used for financing	(432,602)	(56,867)	(495,280)
Cash from continuing operations	(583,584)	(99,998)	(424,818)
Cash from discontinued operations	585,040	98,215	426,316
Increase (decrease) in cash	1,456	(1,783)	1,498
Balance at beginning of year	7,190	8,973	7,475
Balance at end of year	\$ 8,646	\$ 7,190	\$ 8,973

Net interest paid (net of amounts capitalized) in 2004, 2003 and 2002 was \$57.6 million, \$46.2 million and \$65.1 million, respectively. Net income tax payments (refunds) in 2004, 2003 and 2002 were \$66.0 million, \$(13.1) million and \$(16.0) million, respectively.

Certain amounts for 2003 and 2002 have been reclassified to conform to the 2004 presentation as a result of the divestiture of the OSB operations.

The accompanying notes and summary of principal accounting policies are

an integral part of these consolidated financial statements.

POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(Dollars in thousands — except per-share amounts)

	Common Stock Issued		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock		Total Stockholders' Equity
	Shares	Amount				Shares	Amount	
Balance, December 31, 2001	32,721,980	\$32,722	\$129,978	\$ 661,144	\$ —	4,410,528	\$(116,540)	\$ 707,304
Exercise of stock options and stock awards	—	—	141	—	—	(25,050)	662	803
Issuance of treasury stock	—	—	946	—	—	(242,149)	6,397	7,343
Net loss	—	—	—	(234,381)	—	—	—	(234,381)
Minimum pension liability adjustment	—	—	—	—	(33,207)	—	—	(33,207)
Common dividends, \$.60 per share	—	—	—	(17,071)	—	—	—	(17,071)
Balance, December 31, 2002	32,721,980	\$32,722	\$131,065	\$ 409,692	\$ (33,207)	4,143,329	\$(109,481)	\$ 430,791
Exercise of stock options and stock awards	—	—	47	—	—	(49,925)	1,319	1,366
Issuance of treasury stock	—	—	(173)	—	—	(212,187)	5,606	5,433
Performance share awards	—	—	57	—	—	—	—	57
Net earnings	—	—	—	50,727	—	—	—	50,727
Cash flow hedges	—	—	—	—	68	—	—	68
Minimum pension liability adjustment	—	—	—	—	(374)	—	—	(374)
Common dividends, \$.60 per share	—	—	—	(17,217)	—	—	—	(17,217)
Balance, December 31, 2003	32,721,980	\$32,722	\$130,996	\$ 443,202	\$ (33,513)	3,881,217	\$(102,556)	\$ 470,851
Exercise of stock options and stock awards	—	—	7,927	—	—	(1,530,948)	45,231	53,158
Issuance of treasury stock	—	—	1,518	—	—	(108,662)	2,871	4,389
Accelerated stock repurchase	—	—	—	—	—	1,560,397	(75,352)	(75,352)
Income tax benefit resulting from the exercise of employee stock options	—	—	6,225	—	—	—	—	6,225
Performance share awards	—	—	1,185	—	—	—	—	1,185
Net earnings	—	—	—	271,249	—	—	—	271,249
Cash flow hedges	—	—	—	—	(68)	—	—	(68)
Minimum pension liability adjustment	—	—	—	—	32,178	—	—	32,178
Common dividends, \$3.10 per share*	—	—	—	(92,426)	—	—	—	(92,426)
Balance, December 31, 2004	32,721,980	\$32,722	\$147,851	\$ 622,025	\$ (1,403)	3,802,004	\$(129,806)	\$ 671,389

* Includes a special dividend of \$2.50 per common share.

The accompanying notes and summary of principal accounting policies are an integral part of these consolidated financial statements.

POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES
SUMMARY OF PRINCIPAL ACCOUNTING POLICIES

Consolidation

The consolidated financial statements include the accounts of Potlatch Corporation and its subsidiaries after elimination of significant intercompany transactions and accounts. There are no significant unconsolidated subsidiaries.

Potlatch Corporation is an integrated forest products company with substantial timber resources. We are engaged principally in the growing and harvesting of timber and the manufacture and sale of wood products and pulp and paper products. Our timberlands and all of our manufacturing facilities are located within the continental United States. The primary market for our products is the United States, although we sell a significant amount of paperboard to countries in the Pacific Rim.

Certain amounts for 2003 and 2002 have been reclassified in the consolidated financial statements and notes to conform to the 2004 presentation, as a result of the divestiture of our oriented strand board operations.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and assumptions.

Earnings (Loss) Per Common Share

Earnings (loss) per common share are computed by dividing net earnings (loss) by the weighted average number of common shares outstanding in accordance with SFAS No. 128, "Earnings Per Share." The following table reconciles the number of common shares used in the basic and diluted earnings per share calculations:

	2004	2003	2002
Basic average common shares outstanding	29,396,880	28,706,323	28,461,817
Incremental shares due to:			
Common stock options	117,405	12,105	—
Accelerated stock repurchase program	416	—	—
Diluted average common shares outstanding	29,514,701	28,718,428	28,461,817

Incremental shares due to common stock options of 17,042 for the year ended December 31, 2002, were not included in the diluted average common shares outstanding total for 2002 due to their antidilutive effect as a result of our net loss for that year. Stock options to purchase 460,163, 2,327,470 and 1,981,907 shares of common stock for 2004, 2003 and 2002, respectively, were not included in the computation of diluted earnings per share because the exercise prices of the stock options were greater than the average market price of the common shares.

The computation of diluted average common shares outstanding is affected by our accelerated stock repurchase program to the extent that the volume weighted average price of the shares repurchased under the program exceeds the price per share initially paid at the program's inception. That is, it is assumed that any additional amounts payable to the counterparty will be settled by shares of the company's stock, and thus any such differential that exists at the end of each reporting period is included in the computation of diluted average common shares outstanding. The reverse treasury stock method is used to calculate the additional number of shares to be included in the diluted share total.

Table of Contents

Equity-Based Compensation

We currently have three stock incentive plans, the 1989, 1995 and 2000 plans, under which stock options or performance shares are outstanding. Currently, we apply the intrinsic value method under Accounting Principles Board (APB) Opinion No. 25 and related Interpretations in accounting for our equity-based compensation. No compensation cost is recognized for options granted under the plans when the exercise price is equal to market value at the grant date. For performance share awards, which were first granted in December 2003, compensation expense is recorded ratably over the performance period based upon the market value of our stock and the likelihood that performance measurements will be met. Compensation expense related to performance shares was \$1.2 million in 2004 and less than \$0.1 million in 2003.

Had equity-based compensation costs been determined based on the fair value at the grant dates as prescribed by SFAS No. 123 (as amended by SFAS No. 148), our net earnings (loss) and earnings (loss) per share would have been the pro forma amounts indicated below:

	(Dollars in thousands- except per-share amounts)		
	2004	2003	2002
Net earnings (loss), as reported	\$271,249	\$50,727	\$(234,381)
Add: stock based compensation expense recorded under APB No. 25, net of tax	718	35	—
Deduct: stock based compensation determined under SFAS No. 123, net of tax	(1,597)	(1,964)	(1,912)
Pro forma net earnings (loss)	\$270,370	\$48,798	\$(236,293)
Basic net earnings (loss) per share, as reported	\$ 9.23	\$ 1.77	\$ (8.23)
Diluted net earnings (loss) per share, as reported	9.19	1.77	(8.23)
Pro forma basic net earnings (loss) per share	9.20	1.70	(8.30)
Pro forma diluted net earnings (loss) per share	9.17	1.70	(8.30)

As required by SFAS No. 123 (Revised 2004), we will begin recognizing compensation costs in the Statements of Operations for all equity-based compensation plans in the third quarter of 2005. Compensation cost will be determined using the modified prospective method.

Inventories

Inventories are stated at the lower of cost or market. The last-in, first-out method is used to determine cost of logs, lumber, plywood, particleboard and chips. The average cost method is used to determine cost of all other inventories.

Properties

Property, plant and equipment are valued at cost less accumulated depreciation. Depreciation of buildings, equipment and other depreciable assets is determined using the straight-line method of depreciation. Estimated useful lives range from 30 to 40 years for buildings and structures and 2 to 25 years for equipment.

Timber, timberlands and related logging facilities are valued at cost, net of the cost of fee timber harvested and depreciation and amortization of the related logging facilities. For fee timber the capitalized cost includes costs related to stand establishment, such as site preparation, including all costs of preparing the land for planting, cost of seeds or seedlings, whether purchased or company

Table of Contents

produced, tree planting, including labor, materials, depreciation of company-owned equipment and the cost of contract services. Upon completion of planting activities and field inspection to assure the planting operation was successful, a plantation will be considered "established." Subsequent expenditures made to maintain the integrity or enhance the growth of an established plantation or stand are expensed. Post-establishment expenses include release spray treatments, pest control activities, thinning operations and fertilization. Expenditures for forest management consist of regularly recurring items necessary to ownership and administration of timber producing property such as fire protection, property taxes and insurance, silviculture costs incurred subsequent to stand establishment, cruising (physical inventory), property maintenance and salaries, supplies, travel, record-keeping and other normal recurring administrative personnel costs and are accounted for as current operating expenses. Timberland purchased on the open market is capitalized and the cost is allocated to the relative values of the component items as appraised, such as timberland, merchantable sawtimber, merchantable pulpwood, reproduction (young growth not merchantable), logging roads and other land improvements. The capitalized cost includes purchase price, title search and title recording, transfer taxes and fees, cruise of timber, appraisals and running of boundary lines.

The aggregate volume of current standing timber inventory is updated at least annually to reflect increases in merchantable timber due to reclassification of young growth stands to merchantable timber stands, the annual growth rates of merchantable timber, the acquisition of additional merchantable timber, and to reflect decreases due to timber harvests and land sales. Reproduction accounts are reviewed annually, and dollars and volumes are transferred from reproduction accounts to merchantable timber accounts on a reasonable and consistent basis. Volumes and the related accumulated costs are tracked and, as the timber is harvested, the cost per ton is amortized to cost of fee timber harvested. Total standing volume is estimated on an annual basis using inventory data and a forest growth projection model. Inventory is estimated from cruises of the timber tracts, which are completed on all of our timberlands on approximately a 10-year cycle. Since the individual cruises collect field data at different times for specific sites, the growth-model projects standing inventory from the cruise date to a common reporting date. Average annual growth rates for the merchantable inventory have historically been in the range of 2%-3%.

Logging roads and related facilities on land not owned by us are amortized as the related timber is removed. Logging roads and related facilities on our land are presumed to become a part of our road system unless it is known at the time of construction that the road will be abandoned. Therefore, the base cost of the road, such as the clearing, grading, and ditching, is not amortized and remains a capitalized item until abandonment or other disposition, while other portions of the initial cost, such as bridges, culverts and gravel surfacing are depreciated over their useful lives, which range from 10 to 20 years. When it is known at the time of construction or purchase that a road will be abandoned after a given event has occurred, the total cost is amortized in the same manner as for roads on non-owned land.

Major improvements and replacements of property are capitalized. Maintenance, repairs, and minor improvements and replacements are expensed. Upon retirement or other disposition of property, applicable cost and accumulated depreciation or amortization are removed from the accounts. Any gains or losses are included in earnings.

Long-Lived Assets

We account for impairment of long-lived assets in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." The Statement requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Assets to be disposed of are reported at the lower of carrying amount or fair value less cost to sell.

Table of Contents

Income Taxes

The provision for taxes on income is based on earnings or loss reported in the consolidated financial statements. Deferred income taxes are recorded under the asset and liability method for the temporary differences between reported earnings and taxable income using current tax laws and rates.

Environment

As part of our corporate policy, we have an ongoing process to monitor, report on and comply with environmental requirements. Based on this ongoing process, accruals for environmental liabilities are established in accordance with SFAS No. 5, "Accounting for Contingencies." We estimate our environmental liabilities based on various assumptions and judgments, the specific nature of which varies in light of the particular facts and circumstances surrounding each environmental liability. These estimates typically reflect assumptions and judgments as to the probable nature, magnitude and timing of required investigation, remediation and monitoring activities and the probable cost of these activities, and in some cases reflect assumptions and judgments as to the obligation or willingness and ability of third parties to bear a proportionate or allocated share of the cost of these activities. Due to the numerous uncertainties and variables associated with these assumptions and judgments, and the effects of changes in governmental regulation and environmental technologies, both the precision and reliability of the resulting estimates of the related liabilities are subject to substantial uncertainties. We regularly monitor our estimated exposure to environmental liabilities and, as additional information becomes known, our estimates may change significantly. Our estimates of our environmental liabilities do not reflect potential future recoveries from insurance carriers except to the extent that recovery may from time to time be deemed probable as a result of a carrier's agreement to payment terms. In those instances in which our estimated exposure reflects actual or anticipated cost-sharing arrangements with third parties, we do not believe that we will be exposed to additional material liability as a result of non-performance by such third parties. Currently, we are not aware of any material environmental liabilities and have accrued for only specific environmental remediation costs that we have determined are probable and reasonably estimable.

Revenue Recognition

We recognize revenue from product sales to our customers when title and risk of loss pass to the customer. In the case of export sales, title may not pass until the product reaches a foreign port. For land sales, we recognize revenue when title to the land passes to the buyer at closing and collection of proceeds is assured.

Recent Accounting Pronouncements

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs – an amendment of ARB No. 43, Chapter 4." The Statement clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs and spoilage. The Statement also requires that allocation of fixed production overhead costs be based on normal production capacity. The provisions of SFAS No. 151 are effective for inventory costs incurred beginning in January 2006, with adoption permitted for inventory costs incurred beginning in January 2005. Adoption of this Statement is not expected to have a material effect on our financial condition or results of operations.

In December 2004 the FASB issued a revision of SFAS No. 123, "Share-Based Payment." The revised Statement requires the recognition of compensation cost in the Statement of Operations for equity instruments awarded to employees, based on the grant date fair value of the award. The Statement is effective for interim or annual periods beginning after June 15, 2005. We will use the

Table of Contents

modified prospective method to implement the new Statement on July 1, 2005, and believe the effect of adoption on our results of operations will be comparable to the pro forma disclosures contained under the heading “Equity-Based Compensation,” presented earlier in this section.

In December 2004 the FASB also issued SFAS No. 152, “Accounting for Real Estate Time-Sharing Transactions” and SFAS No. 153, “Exchanges of Nonmonetary Assets.” We are not currently engaged in transactions that would fall under the provisions of these Statements and therefore believe that adoption of the Statements on their effective dates will not have a material effect on our financial position or results of operations.

POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Short-term Investments

Short-term investments consist of money market funds and triple-A rated corporate and municipal bonds. These investments have very short maturity periods (from 1 day to 28 days) and earn an average interest rate of approximately two percent. Short-term investments are utilized as required for working capital needs, capital expenditures or other uses by management as considered appropriate.

Note 2. Inventories

	2004	2003
	(Dollars in thousands)	
Logs, pulpwood, chips and sawdust	\$ 15,570	\$ 16,224
Lumber and other manufactured wood products	20,628	16,578
Pulp, paper and converted paper products	88,647	71,410
Materials and supplies	42,170	36,139
	<u>\$167,015</u>	<u>\$140,351</u>
Valued at lower of cost or market:		
Last-in, first-out basis	\$ 35,273	\$ 31,472
Average cost basis	131,742	108,879
	<u>\$167,015</u>	<u>\$140,351</u>

If the last-in, first-out inventory had been priced at lower of current average cost or market, the values would have been approximately \$24.8 million higher at December 31, 2004, and \$27.3 million higher at December 31, 2003. In 2004 and 2003, reductions in quantities of LIFO inventories valued at lower costs prevailing in prior years had the effect of increasing earnings, net of income taxes, by approximately \$2.2 million (\$.08 per common share) and \$0.5 million (\$.02 per common share), respectively.

Note 3. Plant and Equipment

	2004	2003
	(Dollars in thousands)	
Land improvements	\$ 64,806	\$ 62,232
Buildings and structures	214,901	231,388
Machinery and equipment	1,468,100	1,370,119
Construction in progress	15,040	73,470
	<u>\$1,762,847</u>	<u>\$1,737,209</u>

Depreciation charged against income amounted to \$66.0 million in 2004 (\$64.9 million in 2003 and \$67.0 million in 2002).

At December 31, 2004, our authorized capital spending budget, including \$11.7 million carried over from prior years, totaled \$108.5 million. We expect to spend \$107.5 million of this amount in 2005.

Note 4. Timber, Timberlands and Related Logging Facilities

	2004	2003
	(Dollars in thousands)	
Timber and timberlands	\$351,866	\$347,381
Related logging facilities	49,212	49,101
	<u>\$401,078</u>	<u>\$396,482</u>

Table of Contents

The cost of timber harvested from company-owned lands amounted to \$9.6 million in 2004 (\$9.2 million in 2003 and \$10.6 million in 2002). The cost of permit timber harvested from non-company owned lands amounted to \$7.7 million in 2004 (\$8.8 million in 2003 and \$15.8 million in 2002). Amortization of logging roads and related facilities amounted to \$1.8 million in 2004 (\$2.3 million in 2003 and \$2.0 million in 2002).

Note 5. Other Assets

	2004	2003
	(Dollars in thousands)	
Pension assets	\$192,491	\$ 91,779
Other	17,911	26,709
	<u>\$210,402</u>	<u>\$118,488</u>

Note 6. Taxes on Income

The provision (benefit) for taxes on income is comprised of the following:

	2004	2003	2002
	(Dollars in thousands)		
Current*	\$ 65,502	\$ 314	\$ 535
Deferred	110,563	25,425	(150,385)
	<u>\$176,065</u>	<u>\$25,739</u>	<u>\$(149,850)</u>

* The tax benefit related to stock option exercises has been recorded as an increase to additional paid in capital rather than a reduction to the provision for income taxes. The amount of this increase was \$6.2 million for the year ended December 31, 2004.

Included in the provision for 2004 were benefits of \$59.7 million realized from the utilization of net operating loss carryforwards and \$43.4 million of alternative minimum tax credits.

The provision (benefit) for taxes on income differs from the amount computed by applying the statutory federal income tax rate of 35 percent to earnings before taxes on income due to the following:

	2004	2003	2002
	(Dollars in thousands)		
Computed "expected" tax expense (benefit)	\$156,604	\$26,758	\$(134,481)
State and local taxes, net of federal income tax benefits	18,035	2,987	(14,985)
Research tax credits	—	(4,000)	—
All other items	1,426	(6)	(384)
	<u>\$176,065</u>	<u>\$25,739</u>	<u>\$(149,850)</u>
Effective tax rate	<u>39.4%</u>	<u>33.7%</u>	<u>39.0%</u>

Table of Contents

The tax effects of significant temporary differences creating deferred tax assets and liabilities at December 31 were:

	2004	2003
	(Dollars in thousands)	
Deferred Tax Assets:		
Employee benefits	\$ 10,960	\$ 12,864
Postretirement benefits	78,383	75,310
Alternative minimum tax	518	43,868
Net operating losses	—	59,713
Tax credits	9,806	12,644
Discontinued operations	1,499	1,323
Other	6,058	5,266
Total deferred tax assets	107,224	210,988
Valuation allowance	(4,982)	(6,565)
Deferred tax assets, net of valuation allowance	\$ 102,242	\$ 204,423
Deferred Tax Liabilities:		
Plant and equipment	\$(163,344)	\$(187,018)
Timber, timberlands and related logging facilities	(61,703)	(57,644)
Pensions	(65,399)	(16,847)
Total deferred tax liabilities	(290,446)	(261,509)
Net deferred tax liabilities	\$(188,204)	\$ (57,086)
Net deferred tax liabilities consist of:		
Current deferred tax assets ¹	\$ 13,048	\$ 14,831
Noncurrent deferred tax assets	89,194	189,592
Noncurrent deferred tax liabilities	(290,446)	(261,509)
Net noncurrent deferred tax liabilities	(201,252)	(71,917)
Net deferred tax liabilities	\$(188,204)	\$ (57,086)

1 Included in "Prepaid expenses" in the Balance Sheets.

A valuation allowance has been recognized for certain state tax credit carryforwards due to uncertainty of sufficient taxable income prior to expiration of available carryover periods. The valuation allowance decreased from \$6.6 million at December 31, 2003 to \$5.0 million at December 31, 2004.

Our federal income tax returns have been examined, and we have reached final settlement, for all tax years through 1994. The years 1995 through 2003 are currently under examination. In the opinion of management, adequate provision had been made at December 31, 2004, for income taxes that might be due as a result of these audits, and any resulting assessments will have no material effect on our consolidated earnings.

In December 2004, the FASB issued Staff Position (FSP) No. 109-1, "Application of FASB No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004." The FSP states that the qualified production activities deduction should be accounted for as a special deduction in accordance with SFAS No. 109, and provides guidance on assessing the need for a valuation allowance on existing net deferred tax assets due to the qualified production activities deduction. We have determined that no valuation allowance is required as a result of implementing FSP No. 109-1.

The FASB also issued FSP No. 109-2, "Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004." Since we do not have any foreign operations, FSP No. 109-2 is not applicable.

Table of Contents

Note 7. Debt

	2004	2003
	(Dollars in thousands)	
Revenue bonds, fixed-rate 5.9% to 7.75%, due 2004 through 2026	\$159,504	\$170,265
Debentures, 6.95%, due 2015	22,473	22,471
Credit sensitive debentures, 9.125%, due 2009	100,000	100,000
Medium-term notes, fixed-rate 8.27% to 9.35%, due 2006 through 2022	48,950	75,950
Senior subordinated notes, 10%, due 2011	5,504	250,000
Other notes	91	99
	336,522	618,785
Less current installments on long-term debt	1,107	507
Long-term debt	\$335,415	\$618,278

We repaid \$0.5 million of revenue bonds in April 2004 on the normal maturity date. In November 2004, in conjunction with the sale of our OSB operations, we redeemed \$10.3 million of revenue bonds.

We retired \$27.0 million of our medium-term notes in November 2004 through repurchase on the open market. Scheduled maturity of \$5.0 million of the notes was in 2011, with the remaining \$22.0 million scheduled to mature in 2022.

In the fourth quarter of 2004, we announced that our Board of Directors had authorized a tender offer for our outstanding \$250 million 10% Senior Subordinated Notes due 2011. By the end of the offer period, \$244.5 million of the notes had been tendered, and they were subsequently redeemed. We have the right to call the remaining \$5.5 million of the notes beginning July 15, 2006.

The interest rate payable on the 9.125% credit sensitive debentures is subject to adjustment in accordance with the table below if certain changes in the debt rating of the debentures occur. On January 30, 2003, S&P lowered its rating on our senior debt to BB+, causing the interest rate to increase from 9.425% to 12.5% effective on that date. On October 11, 2004, Moody's announced that it had lowered the rating on our senior unsecured debt to Ba1 from Baa3. Because S&P's rating was already at that level the change had no effect on the applicable rate.

Ratings		
Moody's	S&P	Applicable Rate(%)
Aaa	AAA	8.825
Aa1 – Aa3	AA+ – AA –	8.925
A1 – Baa2	A+ – BBB	9.125
Baa3	BBB –	9.425
Ba1	BB+	12.500
Ba2	BB	13.000
Ba3	BB –	13.500
B1 or lower	B+ or lower	14.000

On June 29, 2004, we entered into a new three-year unsecured bank credit facility, which replaced a secured bank credit facility that expired on June 28, 2004. The new credit facility provides a revolving line of credit of up to \$125 million, including a \$35 million subfacility for letters of credit and a \$10 million subfacility for swing line loans. Usage under either or both subfacilities reduces availability under the revolving line of credit. As of December 31, 2004, there were no borrowings outstanding under the revolving line of credit; however, approximately \$10.6 million of the revolving line of credit was used to support outstanding letters of credit.

Table of Contents

Our 10% Senior Subordinated Notes due 2011 are unsecured and are subordinated to our senior notes and our unsecured bank credit facility. In connection with the redemption of substantially all of these outstanding notes in October, we obtained sufficient consents from the note holders to remove from the indenture all restrictive covenants and all events of default, except for payment and bankruptcy defaults.

The agreement governing our unsecured bank credit facility contains certain covenants that, among other things, limits to a certain degree our ability and our subsidiaries' ability to create liens, merge or consolidate, dispose of assets, incur indebtedness and guarantees, pay dividends, repurchase or redeem capital stock and indebtedness, make certain investments or acquisitions, enter into certain transactions with affiliates or change the nature of our business. The unsecured bank credit facility also contains financial maintenance covenants establishing a maximum funded indebtedness to capitalization ratio, a minimum consolidated net worth requirement, and a minimum interest coverage ratio. Events of default under the unsecured bank credit facility and the indenture include, but are not limited to, payment defaults, covenant defaults, breaches of representations and warranties, cross defaults to certain other material agreements and indebtedness, bankruptcy and other insolvency events, material adverse judgments, actual or asserted invalidity of security interests or loan documentation, and certain change of control events involving our company. The company received consent from the participating banks in our credit agreement to allow for the payment of the special dividend to shareholders and to implement the stock repurchase plan. As of December 31, 2004, we were in compliance with the covenants of our unsecured bank credit facility.

Payments due on long-term debt during each of the five years subsequent to December 31, 2004, are as follows:

	(Dollars in thousands)
2005	\$ 1,107
2006	2,358
2007	6,159
2008	209
2009	100,410

Note 8. Accounts Payable and Accrued Liabilities

	2004	2003
	(Dollars in thousands)	
Trade accounts payable	\$ 47,839	\$ 38,647
Accrued wages, salaries and employee benefits	41,303	39,927
Accrued taxes other than taxes on income	10,979	10,926
Accrued interest	4,285	18,074
Accrued taxes on income	3,134	3,709
Book overdrafts	15,058	20,640
Accrued restructuring, mill closure and divestiture charges	4,632	3,541
Other	23,968	22,721
	<u>\$151,198</u>	<u>\$158,185</u>

Note 9. Other Long-Term Obligations

	2004	2003
	(Dollars in thousands)	
Postretirement benefits	\$198,439	\$193,103
Pension and related liabilities	25,298	46,572
Other	10,574	26,839
	<u>\$234,311</u>	<u>\$266,514</u>

Note 10. Financial Instruments

Estimated fair values of our financial instruments are as follows:

	2004		2003	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(Dollars in thousands)			
Cash and short-term investments	\$120,621	\$120,621	\$ 47,169	\$ 47,169
Natural gas collars	—	—	112	112
Interest rate swap	—	—	2,386	2,386
Long-term debt	336,522	377,534	618,785	651,905

For short-term investments the carrying amount approximates fair value. The carrying amount and fair value of our interest rate swap and natural gas collars at December 31, 2003, were based on the then-current termination values. The fair value of our long-term debt is estimated based upon the quoted market prices for the same or similar debt issues. The amount of long-term debt for which there is no quoted market price is immaterial and the carrying amount approximates fair value.

As of December 31, 2003, we held 3.9 million Euro that were to be used for our required Euro payments to the supplier of our new tissue machine under construction in Las Vegas, Nevada. The Euro were classified as a short-term investment on our Balance Sheet and valued at the exchange rate quoted at December 31, 2003. The project was completed in early 2004 and our final Euro payments were made. We subsequently exchanged the remaining Euro for U.S. dollars.

We use derivative financial instruments from time to time as a tool to help us manage our exposure to certain market risks. We enter into derivative financial instruments as hedges against our exposure to market risks only if we believe there is a high probability that changes in the value of the hedging instrument will offset corresponding changes in the underlying exposure. Relationships between hedging instruments and hedged items are formally documented, as well as our risk management objectives and strategies for entering into the transactions. Designated cash flow hedges are linked to forecasted transactions. We also periodically assess whether the derivative financial instruments are effective in offsetting changes in cash flows or the fair value of the hedged items. If a hedge ceases to be highly effective, hedge accounting will be discontinued and derivative instrument gains and losses will be recognized in earnings. We do not enter into derivative contracts for speculative purposes, whether or not we utilize hedge accounting treatment for a specific transaction. The following describes our activities in this area during 2004:

- From December 2001 to August 2004, we entered into several fixed-to-variable interest rate swaps to hedge a portion of our 10% Senior Subordinated Notes. The swaps were designated as fair value hedges and called for the company to pay a variable interest amount, based on LIBOR rates, and receive a fixed-rate payment from a financial institution, calculated on \$165.0 million of our 10% Senior Subordinated Notes. The terms of the interest rate swaps allowed us to assume there was no ineffectiveness in the hedges, and therefore, no amounts representing ineffectiveness were recognized in earnings during the periods the swaps were in effect. In August 2004, we terminated the last of these swaps. The aggregate cash settlements received upon termination of the swaps totaled \$29.2 million, of which \$4.3 million has been ratably accreted to earnings over the term of the underlying debt. In October 2004, as a result of our early repayment of \$244.5 million of the notes, we recognized in earnings \$24.4 million of the aggregate cash settlements received. The balance of the cash settlements, totaling \$0.5 million at December 31, 2004, is being accreted to earnings until the remaining \$5.5 million of outstanding notes mature or are redeemed.

Table of Contents

- During the third quarter of 2003, we entered into several derivative financial instruments designated as cash flow hedges for a portion of our expected natural gas purchases during November 2003 through March 2004. The financial instruments were in the form of collars, and applied to 13,200 mmBtu of natural gas purchased per day for the five-month period beginning November 1, 2003, which represented approximately 60% of our expected daily usage during that period. As designated cash flow hedges, changes in the fair value of the financial instruments were recognized in "Other comprehensive loss," to the extent the hedges were deemed effective, until the hedged item was recognized in the statement of operations. The terms of the instruments allowed us to conclude there was no ineffectiveness and therefore, no amount representing ineffectiveness was recognized in earnings. The reclassification of gains or losses reported in "Other comprehensive loss" to earnings occurred when the related inventory was classified as a cost of sales. As of March 31, 2004, the collars had expired, and the related loss of \$0.1 million was recorded in income by the end of April 2004. We have not entered into any additional instruments to hedge our expected future natural gas purchases.
- In October 2004, our board of directors authorized the repurchase of approximately \$75 million of our outstanding common stock, to be implemented through an accelerated stock repurchase program with a financial counterparty. In November, we repurchased 1,560,397 shares for \$75.4 million, or approximately \$48.29 per share. In connection with the repurchase, the counterparty will purchase shares for its own account in the open market over a nine-month period ending in August 2005. At the end of that period, we will receive or pay a price adjustment based on the volume weighted average price of shares traded during the period. Approximately 808,900 of the shares purchased through the accelerated stock repurchase program are subject to a collar, which sets a minimum and maximum price for shares repurchased, for the purpose of limiting the price adjustment. For the shares subject to the collar, the maximum price adjustment we would receive is equal to \$187,500, or \$.23 per share, and the maximum price adjustment we would pay is equal to \$1,875,000, or \$2.32 per share. The collar is not carried on our balance sheet as an asset or liability because it is a component of a transaction involving our equity securities and can potentially be settled by the issuance of company stock or a cash payment at our discretion. If share settlement is elected by the company, the number of shares we could potentially issue at the end of the repurchase period cannot currently be determined since the number will be dependent upon the amount, if any, that we might owe as a price adjustment, divided by the market price of our common stock on the settlement date.

The following table provides information as of December 31, 2004 regarding the accelerated stock repurchase program:

	Maturity- 2005
Accelerated stock repurchase transaction:	
Collared contract volume (shares)	808,894
Capped settlement amount	\$ 1,875
Floor settlement amount	188
Forward price (per share)	\$ 46.36
Shares purchased by counterparty through 12/31/04 subject to collar	143,998
Uncollared contract volume (shares)	751,503
Initial trade price	\$ 49.90
Shares purchased by counterparty through 12/31/04 not subject to collar	133,782
Average price of repurchased shares through 12/31/04	\$ 49.92

Note 11. Savings, Pension and Other Postretirement Benefit Plans

Substantially all of our employees are eligible to participate in 401(k) savings plans and are covered by noncontributory defined benefit pension plans. These include both company-sponsored and multi-employer plans. In 2004, 2003 and 2002 we made matching 401(k) contributions on behalf of employees of \$5.4 million, \$5.4 million and \$7.3 million, respectively. We also provide benefits under company-sponsored defined benefit retiree health care and life insurance plans, which cover certain salaried and hourly employees. Most of the retiree health care plans require retiree contributions and contain other cost sharing features. The retiree life insurance plans are primarily noncontributory.

We use a December 31 measurement date for our benefit plans. The change in benefit obligation, change in plan assets, funded status and related balance sheet amounts for company-sponsored benefit plans are as follows:

	Pension Benefit Plans		Other Postretirement Benefit Plans	
	2004	2003	2004	2003
	(Dollars in thousands)			
Benefit obligation at beginning of year	\$562,732	\$525,107	\$ 280,964	\$ 242,413
Service cost	10,613	9,060	3,056	2,507
Interest cost	33,880	34,067	17,075	17,006
Plan amendments	5,167	750	(10,541)	(7,684)
Actuarial losses	21,451	35,569	49,726	44,136
Curtailments	—	—	(5,193)	—
Mergers, sales and closures	(4,271)	(1,285)	—	—
Benefits paid	(41,301)	(40,536)	(19,797)	(17,414)
Benefit obligation at end of year	588,271	562,732	315,290	280,964
Fair value of plan assets at beginning of year	555,740	471,390	2	9,813
Actual return on plan assets	57,230	104,206	—	834
Employer contribution	59,111	20,680	—	—
Benefits paid	(41,301)	(40,536)	—	(10,645)
Fair value of plan assets at end of year	630,780	555,740	2	2
Funded status	42,509	(6,992)	(315,288)	(280,962)
Unrecognized prior service cost (benefit)	17,876	15,359	(23,618)	(14,695)
Unrecognized net loss	115,119	97,562	140,467	102,554
Prepaid (accrued) benefit cost	\$175,504	\$105,929	\$(198,439)	\$(193,103)
Amounts recognized in the consolidated balance sheets:				
Prepaid benefit cost	\$192,491	\$122,701	\$ —	\$ —
Accrued benefit cost	(19,306)	(87,061)	(198,439)	(193,103)
Intangible assets	—	15,238	—	—
Accumulated other comprehensive loss	2,319	55,051	—	—
Net amount recognized	\$175,504	\$105,929	\$(198,439)	\$(193,103)

The accumulated benefit obligation for all defined benefit pension plans was \$564.3 million and \$540.8 million at December 31, 2004, and 2003, respectively.

Table of Contents

Information as of December 31 for certain pension plans included above with accumulated benefit obligations in excess of plan assets were as follows:

	2004	2003
	(Dollars in thousands)	
Projected benefit obligation	\$21,765	\$279,680
Accumulated benefit obligation	19,306	278,562
Fair value of plan assets	—	237,660

Net periodic costs (benefit) were:

	Pension Benefit Plans			Other Postretirement Benefit Plans		
	2004	2003	2002	2004	2003	2002
	(Dollars in thousands)					
Service cost	\$ 10,613	\$ 9,060	\$ 10,605	\$ 3,056	\$ 2,507	\$ 3,723
Interest cost	33,880	34,067	36,979	17,075	17,006	16,205
Expected return on plan assets	(58,045)	(57,940)	(62,686)	—	(416)	(1,620)
Amortization of prior service cost	1,806	1,747	2,296	(1,618)	(1,618)	(820)
Recognized actuarial loss (gain)	220	(174)	(5,037)	6,677	5,905	2,790
Recognized net initial asset	—	(37)	(37)	—	—	—
Net periodic cost (benefit)	\$(11,526)	\$(13,277)	\$(17,880)	\$25,190	\$23,384	\$20,278

The pension benefits presented above exclude a \$0.1 million charge for a salaried workforce reduction in 2002, which is included in "Restructuring charges" in the Statements of Operations. The postretirement benefit costs presented above exclude \$1.8 million for the salaried workforce reduction in 2002, which is also included in "Restructuring charges" in the Statements of Operations.

The pension benefits presented above also do not reflect a \$1.1 million charge recorded in 2004 related to the sale of our OSB operations, a cost of \$11.0 million recorded in 2002 related to the sale of our Printing Papers segment assets, and a \$0.2 million charge for the sale of a lumber mill in 2002. These amounts are included in "Gain (loss) from discontinued operations" in the Statements of Operations. Postretirement benefit costs recorded in 2002 totaling \$0.4 million, as a result of these events, are also excluded from the costs presented above and are included in "Gain (loss) from discontinued operations."

In December 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act) was signed into law. The Act introduces a drug benefit under Medicare Part D, as well as a federal subsidy to sponsors of retiree health care benefit plans that provide an equivalent benefit. Pursuant to guidance provided in FSP FAS 106-2, we have determined, with the assistance of consulting actuaries, that certain benefits provided under our plans are actuarially equivalent to the Medicare Part D standard plan and are eligible for the employer subsidy. We have chosen the prospective application option for adoption of the FSP as of July 1, 2004. The effects of the Act on the accumulated postretirement benefit obligation (APBO) were measured at July 1, 2004 and were determined to reduce the APBO by \$25.9 million. The aggregate effect on service cost, interest cost, and amortization of (gain)/loss for the second half of 2004 was an actuarial gain of \$2.2 million. The gain is reflected in the table presented above.

As of December 31, 2004, \$2.3 million of minimum pension liabilities for underfunded plans were included in other long-term liabilities, with a corresponding accumulated other comprehensive loss of \$1.4 million, which is net of deferred taxes of \$0.9 million. As of December 31, 2003, \$70.3 million of minimum pension liabilities were included in other long-term liabilities, with corresponding intangible assets of \$15.2 million and accumulated other comprehensive loss of \$33.6 million, which is net of deferred taxes of \$21.5 million. Pension plan underfunding was reduced in 2004, despite a decrease in the discount rate, due largely to contributions made in December 2004 totaling \$57.9 million.

Table of Contents

Weighted average assumptions used to determine the benefit obligation as of December 31 were:

	Pension Benefit Plans			Other Postretirement Benefit Plans		
	2004	2003	2002	2004	2003	2002
Discount rate	5.90%	6.25%	6.75%	5.90%	6.25%	6.75%
Expected return on plan assets	9.50	9.50	9.50	9.00	9.00	9.00
Rate of salaried compensation increase	4.00	4.00	4.00	—	—	—

Weighted average assumptions used to determine the net periodic benefit (cost) for the years ended December 31 were:

	Pension Benefit Plans			Other Postretirement Benefit Plans		
	2004	2003	2002	2004	2003	2002
Discount rate	6.25%	6.75%	7.25%	6.25%	6.75%	7.25%
Expected return on plan assets	9.50	9.50	9.50	9.00	9.00	9.00
Rate of salaried compensation increase	4.00	4.00	5.00	—	—	—

The expected return on plan assets assumption is based upon an analysis of historical long-term returns for various investment categories, as measured by appropriate indices. These indices are weighted based upon the extent to which plan assets are invested in the particular categories in arriving at our determination of a composite expected return. Over the past 27 years, the period we have actively managed pension assets, our actual average annual return on pension plan assets has been approximately 12%.

The health care cost trend rate assumption used in determining the accumulated postretirement benefit obligation is 7.00% for 2004. The rate is scheduled for adjustment to 12.00% in 2005 and assumed to decrease one percent annually to 6.00% in 2011 and remain at that level thereafter. This assumption has a significant effect on the amounts reported. A one percentage point change in the health care cost trend rates would have the following effects:

	1% Increase	1% Decrease
	(Dollars in thousands)	
Effect on total of service and interest cost components	\$ 2,677	\$ (2,235)
Effect on postretirement benefit obligation	35,628	(30,267)

The weighted average asset allocations at December 31 by asset category are as follows:

Asset category	Pension Benefit Plans		Other Postretirement Benefit Plans	
	2004	2003	2004	2003
Domestic equity securities	64%	63%	— %	— %
Global equity securities	9	10	—	—
Debt securities	22	25	—	—
Other	5	2	100	100
Total	100%	100%	100%	100%

We utilize formal investment policy guidelines for our company-sponsored pension plans. These guidelines are approved by the board of directors and are periodically reviewed, as the board of directors has ultimate fiduciary responsibility for pension plan assets. The board of directors has delegated its authority to management to insure that the investment policy and guidelines are adhered to and the investment objectives are met.

Table of Contents

The general policy states that plan assets will be invested to seek the greatest return consistent with the fiduciary character of the pension funds and to allow the plans to meet the need for timely pension benefit payments. The specific investment guidelines stipulate that adequate liquidity will be maintained for meeting expected benefit payments by reviewing, on a timely basis, contribution and benefit payment levels and appropriately revising long-term and short-term asset allocations. Management takes reasonable and prudent steps to preserve the value of pension fund assets and to avoid the risk of large losses. Major steps taken to provide this protection include:

- Assets are diversified among various asset classes, such as domestic equities, global equities, fixed income, convertible securities, venture capital and liquid reserves. The long-term asset allocation ranges are as follows:

Domestic and global equities	50%-80%
Fixed income and convertible securities	15%-40%
Venture Capital	00%-05%
Liquid reserves	00%-10%

The ranges are more heavily weighted toward equities since the liabilities of the pension plans are long-term in nature and equities have proven to significantly outperform other asset classes over long periods of time. Periodic reviews of allocations within these ranges are made to determine what adjustments should be made based on changing economic and market conditions and specific liquidity requirements.

- Assets are managed by professional investment managers and may be invested in separately managed accounts or commingled funds. Assets will be diversified by selecting different investment managers for each asset class and by limiting assets under each manager to no more than 25% of the total pension fund.
- Assets, other than venture capital, are not invested in securities rated below BBB- by S&P or Baa3 by Moody's.
- Assets are not invested in Potlatch stock.

The investment guidelines also require that the individual investment managers will be expected to achieve a reasonable rate of return over a market cycle. Emphasis will be placed on long-term performance versus short-term market aberrations. Factors to be considered in determining reasonable rates of return include performance achieved by a diverse cross section of other investment managers, performance of commonly used benchmarks (e.g., S&P 500 Index, Shearson Lehman Government/Corporate Intermediate Index, Morgan Stanley World Index, Merrill Lynch Investment Grade Convertibles Index, Consumer Price Index), actuarial assumptions for return on plan investments and specific performance guidelines given to individual investment managers.

During 2004, eight active investment managers managed substantially all of the pension funds, each of whom had responsibility for managing a specific portion of these assets. Plan assets were diversified among the various asset classes within the allocation ranges approved by the board of directors.

We estimate contributions to defined benefit pension plans will total \$1.4 million in 2005. We do not anticipate funding our postretirement benefit plans in 2005 except to pay benefit costs as incurred during the year by plan participants.

Table of Contents

Estimated future benefit payments, which reflect expected future service and expected medicare prescription subsidy receipts are as follows for the years indicated:

	Pension Benefit Plans	Other Postretirement Benefit Plans	Expected Medicare Subsidy
		(Dollars in thousands)	
2005	\$ 41,924	\$ 20,500	\$ —
2006	41,469	21,900	1,163
2007	40,911	23,300	1,224
2008	40,836	24,200	1,292
2009	40,500	25,100	1,348
2010-2014	207,681	137,500	7,523

Hourly employees at two of our manufacturing facilities participate in multi-employer defined benefit pension plans, the Paper, Allied-Industrial, Chemical and Energy Workers International Union (PACE) Pension Fund and the International Association of Machinist & Aerospace Workers (IAMA) National Pension Fund, to which we make contributions. We also make contributions to a trust fund established to provide retiree medical benefits for a portion of these employees, which is managed by PACE. Company contributions to these plans in 2004, 2003 and 2002 amounted to \$7.9 million, \$7.7 million and \$6.4 million, respectively.

Note 12. Commitments and Contingencies

We have operating leases covering office, warehouse and distribution space, equipment and vehicles expiring at various dates through 2019. As leases expire, it can be expected that, in the normal course of business, certain leases will be renewed or replaced.

As of December 31, 2004, the future minimum rental payments required under our operating leases are as follows:

	(Dollars in thousands)
2005	\$ 12,039
2006	10,756
2007	9,455
2008	8,753
2009	6,033
2010 and later years	31,849
Total	\$ 78,885

Rent expense for continuing operations was \$13.0 million, \$8.7 million and \$5.2 million for the years ended December 31, 2004, 2003 and 2002, respectively.

In late January 2004, we voluntarily reported to the Minnesota Pollution Control Agency (MPCA) a potential air permit violation at our former, oriented strand board facility in Bemidji, Minnesota (sold in September 2004), relating to the non-operation of equipment used to control nitrous oxide emissions from a wood-fired boiler for a period of approximately 29 months. Corrective action was taken, and we have cooperated with the MPCA in its investigation. The MPCA has completed its investigation, and we and the MPCA are discussing a proposed settlement agreement, including the amount of a proposed penalty, which we believe will be less than \$1 million. We have established a reserve in accordance with SFAS No. 5.

Taking into consideration the amount of the proposed penalty to be assessed in the above described matter, we believe there is no pending or threatened litigation that would have a material adverse effect on our financial position, operations or liquidity.

Note 13. Equity-Based Compensation Plans

We currently have three stock incentive plans under which stock option and performance share grants are issued and outstanding. All of these plans have received shareholder approval. Options are granted with an exercise price equal to market value at the grant date and prior to 1995 may have included a stock appreciation right. Options are fully exercisable after two years and expire not later than 10 years from the date of grant. We were originally authorized to issue up to 1.5 million shares, 1.7 million shares and 1.4 million shares under our 1989 Stock Incentive Plan, 1995 Stock Incentive Plan and 2000 Stock Incentive Plan, respectively. At December 31, 2004, no shares were available for future use under the 1989 and 1995 Stock Incentive Plans, while approximately 313,000 shares were authorized for future use under the 2000 Stock Incentive Plan.

In November 2004, we paid a special dividend of \$2.50 per common share to our stockholders. The amount of the special dividend qualified as an equity restructuring event. Under APB No. 25 rules, in order to maintain the same intrinsic value to option holders immediately before and after the special dividend was paid, the number of options granted and exercise prices of all outstanding stock options were adjusted after the record date for the special dividend payment. The adjustments are reflected in the activity for 2004 presented in the table below.

A summary of the status of outstanding stock options as of December 31, 2004, 2003 and 2002 and changes during those years is presented below:

Options	2004		2003		2002	
	Shares	Weighted Avg. Exercise Price	Shares	Weighted Avg. Exercise Price	Shares	Weighted Avg. Exercise Price
Outstanding at January 1	2,716,820	\$ 36.19	2,836,357	\$ 36.67	2,993,000	\$ 38.63
Granted	122,785	50.75	150,070	33.18	378,300	24.87
Adjustment as a result of special dividend	84,513	36.35	—	—	—	—
Shares exercised	(1,530,948)	34.72	(49,925)	27.37	(25,050)	32.06
SARs exercised	(36,600)	36.83	—	—	—	—
Canceled or expired	(48,755)	28.07	(219,682)	42.32	(509,893)	39.67
Outstanding at December 31	1,307,815	37.23	2,716,820	36.19	2,836,357	36.67
Options exercisable	1,112,008	36.10	2,385,000	37.25	2,263,594	39.33
Options outstanding which include a stock appreciation right	—	—	41,700	—	78,600	—
Shares reserved for future grants	313,007	—	569,042	—	793,963	—
Fair value of options granted during the year	\$ 6.99	—	\$ 11.72	—	\$ 7.20	—

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions used for grants in 2004, 2003 and 2002, respectively: dividend yield of 6.11, 1.73 and 2.41 percent; stock volatility of .2655, .2737 and .2538; risk free rate of return of 4.35, 4.36 and 4.17 percent; and expected term of 10 years for all grants. The significant change in dividend yield for 2004 compared to 2003 and 2002 is due to the \$2.50 special dividend paid during the year.

Table of Contents

The following table summarizes information about stock options outstanding at December 31, 2004:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding at 12/31/04	Weighted Avg. Remaining Contractual Life	Weighted Avg. Exercise Price	Number Exercisable at 12/31/04	Weighted Avg. Exercise Price
\$22.7476 to \$27.9296	252,185	7.79 years	\$ 24.45	252,185	\$ 24.45
\$30.5421 to \$39.4130	595,467	5.37 years	35.76	522,445	36.34
\$42.2707 to \$50.7500	460,163	4.57 years	46.13	337,378	44.45
\$22.7476 to \$50.7500	1,307,815	5.56 years	37.23	1,112,008	36.10

Options may also be issued in the form of restricted stock and other share-based awards. In December 2004 and 2003, awards for 73,825 and 59,270 shares of stock, respectively, were granted under performance-based award programs. The performance share awards have a three-year performance period and performance shares will be issued at the end of the period if the performance measure is met. The performance measure is a comparison of the percentile ranking of our total shareholder return compared to the total shareholder return performance of a selected peer group of forest product companies. The number of performance shares actually issued, as a percentage of the amounts initially granted, could range from 0%-150% for the 2003 grant and 0%-200% for the 2004 grant. Performance shares granted under the program may not be voted until issued. A dividend equivalent will be calculated based upon performance shares earned and will be paid out as additional shares. In accordance with APB No. 25, we recognize compensation expense over the performance period equal to the market value of our stock multiplied by the number of performance shares expected to be issued. Compensation expense in 2004 and 2003 related to performance shares was \$1.2 million and less than \$0.1 million, respectively.

Note 14. Segment Information

As of December 31, 2004, our operations were divided into four reporting segments: Resource, Wood Products, Pulp and Paperboard, and Consumer Products, based upon similarities in product lines, manufacturing processes, marketing and management of our businesses. The Resource segment manages our timberland base, purchases wood fiber and timberlands from third parties, provides wood fiber to the manufacturing segments and sells wood fiber and timberlands to third parties. The Wood Products segment produces lumber, plywood and particleboard. The Pulp and Paperboard segment produces paperboard and pulp. The Consumer Products segment produces consumer tissue products.

As a result of the sale of our OSB operations in September 2004 to Ainsworth Lumber Co. Ltd., the wood products segment information for the periods presented in the table below has been adjusted to reflect those operations as discontinued operations.

The reporting segments follow the same accounting policies used for our consolidated financial statements, as described in the summary of significant accounting policies, with the exception of the valuation of inventories. All segment inventories are reported using the average cost method and the LIFO reserve is recorded at the corporate level. Management evaluates a segment's performance based upon profit or loss from operations before income taxes. Intersegment sales or transfers are recorded based on prevailing market prices.

Table of Contents

Following is a tabulation of business segment information for each of the past three years. Corporate information is included to reconcile segment data to the consolidated financial statements.

	2004	2003	2002
	(Dollars in thousands)		
Segment Sales:			
Resource	\$ 274,292	\$ 252,614	\$ 411,833
Wood products:			
Lumber	345,800	279,192	249,790
Plywood	59,647	46,402	34,915
Particleboard	18,747	15,230	14,083
Other	26,810	28,063	23,077
	451,004	368,887	321,865
Pulp and paperboard:			
Paperboard	463,608	420,805	395,085
Pulp	65,705	61,239	48,483
	529,313	482,044	443,568
Consumer products:			
Tissue	320,052	300,896	315,708
	1,574,661	1,404,441	1,492,974
Elimination of intersegment sales	(223,189)	(212,004)	(386,668)
Total consolidated net sales	\$1,351,472	\$1,192,437	\$1,106,306
Intersegment Sales or Transfers ¹ :			
Resource	\$ 164,396	\$ 157,233	\$ 339,169
Wood products	12,000	11,715	12,436
Pulp and paperboard	46,712	42,971	34,975
Consumer products	81	85	88
Total	\$ 223,189	\$ 212,004	\$ 386,668
Operating Income (Loss):			
Resource	\$ 69,901	\$ 65,511	\$ 62,554
Wood products	68,330	4,078	(11,109)
Pulp and paperboard	11,012	(15,104)	(42,821)
Consumer products	(10,155)	1,266	42,806
Eliminations and adjustments	(508)	(181)	(3,389)
	138,580	55,570	48,041
Corporate Items:			
Administration expense	(45,851)	(34,706)	(33,341)
Interest expense	(45,863)	(48,172)	(59,882)
Interest income	3,617	14,090	1,930
Restructuring charge	—	476	(8,963)
Debt retirement costs	(25,186)	(248)	(15,360)
Consolidated income (loss) before taxes on income	\$ 25,297	\$ (12,990)	\$ (67,575)
Depreciation, Amortization and Cost of Fee Timber Harvested:			
Resource	\$ 19,621	\$ 20,917	\$ 28,791
Wood products	12,709	13,177	13,108
Pulp and paperboard	37,240	38,171	39,866
Consumer products	15,239	12,585	13,028
	84,809	84,850	94,793
Corporate	3,510	4,137	3,193
Total	\$ 88,319	\$ 88,987	\$ 97,986
Assets:			
Resource	\$ 441,564	\$ 438,495	\$ 426,212
Wood products	162,583	164,976	179,270
Pulp and paperboard	407,148	418,706	446,362
Consumer products	268,840	245,581	231,387
	1,280,135	1,267,758	1,283,231
Assets held for sale	—	176,596	187,438

Corporate	314,537	153,023	154,148
	<u> </u>	<u> </u>	<u> </u>
Total consolidated assets	\$1,594,672	\$1,597,377	\$1,624,817
	<u> </u>	<u> </u>	<u> </u>
Capital Expenditures:			
Resource	\$ 14,982	\$ 15,519	\$ 15,346
Wood products	6,836	7,299	5,830
Pulp and paperboard	10,329	5,193	3,972
Consumer products	14,921	47,881	23,446
	<u> </u>	<u> </u>	<u> </u>
	47,068	75,892	48,594
Corporate	1,832	198	330
	<u> </u>	<u> </u>	<u> </u>
Total	\$ 48,900	\$ 76,090	\$ 48,924
	<u> </u>	<u> </u>	<u> </u>

Table of Contents

- 1 Intersegment sales for 2002-2004, which were based on prevailing market prices, consisted primarily of logs, chips, pulp logs and other fiber sales by our Resource segment to the Wood Products and Pulp and Paperboard segments.

All of our manufacturing facilities and all other assets are located within the continental United States. However, we sell and ship products to many foreign countries. Geographic information regarding our net sales is summarized as follows:

	2004	2003	2002
	(Dollars in thousands)		
United States	\$1,231,704	\$1,086,008	\$1,009,919
Japan	58,622	48,666	48,224
Australia	9,216	6,498	4,881
Canada	14,041	12,763	9,085
China	18,936	14,711	12,303
Italy	954	7,013	6,543
Korea	7,612	9,842	11,210
Taiwan	5,553	3,996	2,498
Other foreign countries	4,834	2,940	1,643
Total consolidated net sales	\$1,351,472	\$1,192,437	\$1,106,306

Note 15. Restructuring Charges

The following is a description of the charges included in the "Restructuring charges" line in the Statements of Operations.

A pre-tax charge of \$1.3 million was recorded in January 2004 for a workforce reduction at our Consumer Products segment. A total of 60 production and 8 salaried employees were terminated. By June 2004, all costs had been incurred for the workforce reduction, resulting in a reversal to the initial charge of less than \$0.1 million.

In 2002, we recorded a \$9.0 million pre-tax charge for costs associated with the elimination of 106 salaried production and administrative positions. In the first quarter of 2003, we recorded charges totaling \$0.2 million for costs related to terminated employees whose service had been retained beyond the initial 60-day period. In December 2003, we recorded a \$0.7 million credit, reflecting final cost determinations for pension and medical benefits. As of December 31, 2004, 102 employees had been terminated and four had assumed other positions within the company as a result of job openings.

Note 16. Discontinued Operations

On August 25, 2004, we entered into a definitive agreement with Ainsworth Lumber Co. Ltd. for the sale of our OSB facilities and associated assets for approximately \$452 million in cash, after closing adjustments. The sale was completed in September 2004. As a result of the transaction, we recorded an after-tax gain of \$163.1 million in the third quarter of 2004. These amounts, in addition to after-tax operating income from the OSB operations for 2004 of \$92.8 million, are classified as discontinued operations in the Statements of Operations. After-tax operating income (loss) for the OSB operations in 2003 and 2002 of \$57.1 million and \$(9.7) million, respectively, have been reclassified to discontinued operations.

In May 2002, we completed the sale of our Cloquet, Minnesota, pulp and printing papers facilities and certain associated assets to a domestic subsidiary of Sappi Limited for \$485.5 million in cash,

Table of Contents

after closing adjustments. As a result of the transaction, we recorded an after-tax charge of \$149.8 million in the first quarter of 2002. In December 2002, we recorded an additional after-tax charge of \$14.6 million to adjust employee severance costs, the carrying value of the remaining unsold printing papers assets and other exit costs. The charges and 2002 operating losses of \$13.9 million, after-tax, are presented as discontinued operations in the Statements of Operations.

In conjunction with the sale of our Cloquet facility, we closed our Brainerd, Minnesota, printing papers mill. The facility was sold on February 28, 2003, for \$4.44 million in cash. We recorded a loss on discontinued operations in 2003 of \$2.5 million, after-tax, which included costs for maintaining the facility before its sale, an additional loss on the sale and recognition of a continuing contractual obligation.

We sold our Bradley hardwood mill in Warren, Arkansas, in August 2002. An initial after-tax charge of \$5.7 million was recorded for estimated asset write-down and closure costs. In December 2002, we reversed \$1.6 million of the initial charge, after tax, to reflect actual costs incurred for the closure and sale. The net charge and 2002 operating losses of \$1.0 million, after tax, are also presented as discontinued operations in the Statements of Operations.

The assets and liabilities of the OSB operations are presented in the Balance Sheets under the captions "Assets held for sale" and "Liabilities related to assets held for sale." The carrying amounts of the major classes of these assets and liabilities at December 31 were as follows:

	2004	2003
	(Dollars in thousands)	
Assets:		
Cash	\$—	\$ —
Receivables, net	—	14,295
Inventories	—	19,327
Land, other than timberlands	—	981
Plant and equipment, net	—	139,378
Timber, timberlands and related logging facilities, net	—	2,418
Other assets	—	197
Total assets held for sale	\$—	\$ 176,596
Liabilities:		
Accounts payable and accrued liabilities	\$—	\$ 11,125

Table of Contents

Note 17. Financial Results by Quarter (Unaudited)

	Three Months Ended							
	March 31		June 30		September 30		December 31	
	2004	2003	2004	2003	2004	2003	2004	2003
	(Dollars in thousands — except per-share amounts)							
Net sales	\$ 316,529	\$ 282,569	\$ 343,245	\$ 305,684	\$ 370,100	\$ 307,174	\$ 321,598	\$ 297,010
Costs and expenses:								
Depreciation, amortization and cost of fee timber harvested	23,173	22,842	21,158	21,257	22,465	21,822	21,523	23,066
Materials, labor and other operating expenses	269,456	243,712	276,718	261,111	275,564	258,748	261,922	243,215
Selling, general and administrative expenses	21,211	16,198	21,775	19,125	20,668	19,264	21,917	21,213
Restructuring charges	1,280	227	(87)	—	—	—	—	(703)
	315,120	282,979	319,564	301,493	318,697	299,834	305,362	286,791
Earnings (loss) from operations	\$ 1,409	\$ (410)	\$ 23,681	\$ 4,191	\$ 51,403	\$ 7,340	\$ 16,236	\$ 10,219
Earnings (loss) from continuing operations	\$ (6,297)	\$ (7,994)	\$ 7,126	\$ 2,828	\$ 24,199	\$ (1,214)	\$ (9,698)	\$ 2,538
Earnings (loss) from discontinued operations, net of tax	\$ 28,115	\$ (1,571)	\$ 42,442	\$ 3,821	\$ 185,648	\$ 23,370	\$ (286)	\$ 28,949
Net earnings (loss)	\$ 21,818	\$ (9,565)	\$ 49,568	\$ 6,649	\$ 209,847	\$ 22,156	\$ (9,984)	\$ 31,487
Net earnings (loss) per common share from continuing operations:								
Basic	\$ (.22)	\$ (.28)	\$.24	\$.10	\$.82	\$ (.04)	\$ (.33)	\$.09
Diluted	(.21)	(.28)	.24	.10	.81	(.04)	(.33)	.09
Net earnings (loss) per common share:								
Basic	.75	(.33)	1.68	.23	7.08	.77	(.34)	1.10
Diluted	.74	(.33)	1.68	.23	7.05	.77	(.34)	1.10

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Potlatch Corporation:

We have audited the accompanying consolidated balance sheets of Potlatch Corporation and consolidated subsidiaries as of December 31, 2004 and 2003, and the related consolidated statements of operations and comprehensive income, cash flows and stockholders' equity for each of the years in the three-year period ended December 31, 2004. In connection with our audits of the consolidated financial statements, we also have audited the financial statement schedule on page 70. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Potlatch Corporation and consolidated subsidiaries as of December 31, 2004 and 2003, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2004, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Potlatch Corporation and consolidated subsidiaries' internal control over financial reporting as of December 31, 2004, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 18, 2005 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

KPMG LLP

Portland, Oregon
February 18, 2005

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Potlatch Corporation:

We have audited management's assessment, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting, that Potlatch Corporation and consolidated subsidiaries maintained effective internal control over financial reporting as of December 31, 2004, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Potlatch Corporation and consolidated subsidiaries' management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of Potlatch Corporation and consolidated subsidiaries' internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Potlatch Corporation and consolidated subsidiaries maintained effective internal control over financial reporting as of December 31, 2004, is fairly stated, in all material respects, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, in our opinion, Potlatch Corporation and consolidated subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2004, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Potlatch Corporation and

Table of Contents

consolidated subsidiaries as of December 31, 2004 and 2003, and the related consolidated statements of operations and comprehensive income, cash flows and stockholders' equity for each of the years in the three-year period ended December 31, 2004, and our report dated February 18, 2005 expressed an unqualified opinion on those consolidated financial statements.

KPMG LLP

Portland, Oregon
February 18, 2005

POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES
Valuation and Qualifying Accounts
For the Years Ended December 31, 2004, 2003 and 2002
(Dollars in thousands)

Description	Balance at beginning of year	Amounts charged (credited) to costs and expenses	Deductions 1	Balance at end of year 2
Reserve deducted from related assets:				
Doubtful accounts —				
Accounts receivable				
Year ended December 31, 2004	\$ 1,285	\$ 12	\$ (71)	\$1,226
Year ended December 31, 2003	\$ 1,624	\$ 376	\$ (715)	\$1,285
Year ended December 31, 2002	\$ 1,589	\$ 881	\$ (846)	\$1,624

1 Accounts written off, net of recoveries.

2 Year-end balances for 2003 and 2002 include reserves for discontinued operations of \$150.

POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

Exhibit Index

Exhibit	
(2)*	Asset Purchase Agreement, dated as of March 18, 2002, between Potlatch Corporation, Sappi Limited and Northern Holdings LLC, now known as Sappi Cloquet LLC, filed as Exhibit (2) to the Quarterly Report on Form 10-Q for the quarter ended March 31, 2002. (The Registrant agrees to furnish supplementally to the Commission upon request a copy of any omitted schedule.)
(2)(a)*	Asset Purchase Agreement, dated as of August 25, 2004, between Potlatch Corporation and Ainsworth Lumber Co. Ltd., filed as Exhibit 21 to the Current Report on Form 8-K filed September 21, 2004. (The Registrant agrees to furnish supplementally to the Commission upon request a copy of any omitted schedule.)
(3)(a)*	Restated Certificate of Incorporation, filed as Exhibit (3)(a) to the Annual Report on Form 10-K for the fiscal year ended December 31, 2002 ("2002 Form 10-K").
(3)(c)*	By-laws, as amended through September 17, 2004, filed as Exhibit (3)(ii) to the Current Report on Form 8-K dated September 23, 2004.
(4)	See Exhibits (3)(a) and (3)(c). Registrant also undertakes to furnish to the Securities and Exchange Commission, upon request, any instrument defining the rights of holders of long-term debt.
(4)(a)*	Form of Indenture, dated as of November 27, 1990, filed as Exhibit (4)(a) to the Annual Report on Form 10-K for the fiscal year ended December 31, 2000 ("2000 Form 10-K").
(4)(a)(i)*	Officers' Certificate, dated January 24, 1991, filed as Exhibit (4)(a)(i) to the 2000 Form 10-K.
(4)(a)(ii)*	Officers' Certificate, dated December 12, 1991, filed as Exhibit (4)(a)(ii) to the Annual Report on Form 10-K for the fiscal year ended December 31, 2001 ("2001 Form 10-K").
(4)(b)*	Form of Indenture, dated as of June 29, 2001, for the 10% Senior Subordinated Notes due 2011, filed as Exhibit (10)(o) to the Quarterly Report on Form 10-Q for the quarter ended June 30, 2001.
(4)(b)(i)*	First Supplemental Indenture, dated as of October 21, 2004, amending Exhibit (4)(b), filed as Exhibit 4.1 to the Current Report on Form 8-K dated October 21, 2004.
(10)(a) ¹	Potlatch Corporation Management Performance Award Plan, as amended effective December 2, 2004.
(10)(b) ^{1*}	Potlatch Corporation Severance Program for Executive Employees, as amended and restated as of December 1, 1999, filed as Exhibit (10)(b) to the Quarterly Report on Form 10-Q for the quarter ended June 30, 2000.
(10)(c) ¹	Potlatch Corporation 2000 Stock Incentive Plan, adopted December 2, 1999.
(10)(c)(i) ¹	Amendment No. 1 to Exhibit (10)(c).
(10)(c)(ii) ^{1*}	Form of employee Stock Option agreement for the Potlatch Corporation 2000 Stock Incentive Plan together with the Addendum thereto as used for options granted in December 2000, 2001, 2002, 2003 and 2004, filed as Exhibit (10)(c)(i) to the 2001 Form 10-K.
(10)(c)(iii) ^{1*}	Form of outside director Stock Option agreement for the Potlatch Corporation 2000 Stock Incentive Plan together with the Addendum thereto as used for options granted in December 2000, 2001, 2002 and 2003, filed as Exhibit (10)(c)(ii) to the 2001 Form 10-K.

Table of Contents

<u>Exhibit</u>	
(10)(d) ^{1 *}	Potlatch Corporation Salaried Employees' Supplemental Benefit Plan (As Amended and Restated Effective January 1, 1989), filed as Exhibit (10)(d) to the Annual Report on Form 10-K for the fiscal year ended December 31, 2003 ("2003 Form 10-K").
(10)(d)(i) ^{1 *}	Amendment, effective as of January 1, 1998, to Plan described in Exhibit (10)(d), filed as Exhibit (10)(d)(i) to the 2003 Form 10-K.
(10)(g) ^{1 *}	Potlatch Corporation Deferred Compensation Plan for Directors, as amended through May 18, 2000, filed as Exhibit (10)(g) to the Quarterly Report on Form 10-Q for the quarter ended June 30, 2000.
(10)(h) ^{1 *}	Potlatch Corporation Benefits Protection Trust Agreement, as amended and restated effective September 20, 2002, filed as Exhibit (10)(h) to the Quarterly Report on Form 10-Q for the quarter ended September 30, 2002.
(10)(i) ^{1 *}	Compensation of Directors, dated May 20, 2004, filed as Exhibit (10)(i) to the Quarterly Report on Form 10-Q for the quarter ended June 30, 2004.
(10)(j) ^{2 *}	Form of Indemnification Agreement with each director of Potlatch Corporation as set forth on Schedule A, filed as Exhibit (10)(j) to the 2001 Form 10-K.
(10)(j)(i) ^{2 *}	Amendment No. 2 to Schedule A to Exhibit (10)(j), filed as Exhibit (10)(j)(i) to the 2003 Form 10-K.
(10)(k) ^{2 *}	Form of Indemnification Agreement with certain officers of Potlatch Corporation as set forth on Schedule A, filed as Exhibit (10)(k) to the 2001 Form 10-K.
(10)(k)(i) ²	Amendment No. 5 to Schedule A to Exhibit (10)(k).
(10)(l) ¹	Potlatch Corporation 1989 Stock Incentive Plan adopted December 8, 1988, and as amended and restated December 2, 1999.
(10)(l)(ii) ^{1 *}	Form of Stock Option Agreement for the Potlatch Corporation 1989 Stock Incentive Plan together with the Addendum thereto as used for options granted in each December of 1990-1997, filed as Exhibit (10)(l)(ii) to the 2000 Form 10-K.
(10)(l)(iii) ^{1 *}	Form of Stock Option Agreement for the Potlatch Corporation 1989 Stock Incentive Plan together with the Addendum thereto as used for options granted in December, 1998 filed as Exhibit (10)(l)(iii) to the 2003 Form 10-K.
(10)(m)(i) ^{1 *}	Form of Amendments, dated January 12, 1999, to outstanding employee Stock Option Agreements, filed as Exhibit (10)(m)(i) to the 2003 Form 10-K.
(10)(m)(ii) ^{1 *}	Form of Amendment, dated December 29, 1998, to outstanding outside director Stock Option Agreements, filed as Exhibit (10)(m)(ii) to the 2003 Form 10-K.
(10)(n) ¹	Potlatch Corporation 1995 Stock Incentive Plan adopted December 7, 1995, as amended and restated December 2, 1999.
(10)(n)(i) ^{1 *}	Form of Stock Option Agreement used for employees for the Potlatch Corporation 1995 Stock Incentive Plan together with the Addendum thereto as used for options granted in December, 1995 filed as Exhibit (10)(n)(i) to the 2000 Form 10-K.
(10)(n)(ii) ^{1 *}	Form of Addendum used in connection with the Stock Option Agreement set forth in Exhibit (10)(n)(i) for options granted in each December, 1996 and 1997, filed as Exhibit (10)(n)(ii) to the 2001 Form 10-K.
(10)(n)(iii) ^{1 *}	Form of Stock Option Agreement used for outside directors for the Potlatch Corporation 1995 Stock Incentive Plan together with the form of Addendum used for options granted in December 1995 and the Form of Addendum used for options granted in each December 1996 and 1997, filed as Exhibit (10)(n)(iii) to the 2001 Form 10-K.

Table of Contents

<u>Exhibit</u>	
(10)(n)(iv) ¹ *	Form of employee Stock Option Agreement for the Potlatch Corporation 1995 Stock Incentive Plan together with the Addendum thereto as used for options granted in December 1998, filed as Exhibit (10)(n)(iv) to the 2003 Form 10-K.
(10)(n)(v) ¹ *	Form of outside director Stock Option Agreement for the Potlatch Corporation 1995 Stock Incentive Plan together with the Addendum thereto as used for options granted in December 1998, filed as Exhibit (10)(n)(v) to the 2003 Form 10-K.
(10)(n)(vi) ¹	Form of employee Stock Option Agreement for the Potlatch Corporation 1995 Stock Incentive Plan together with the Addendum thereto as used for options granted in December 1999, 2000, 2001 and 2002.
(10)(n)(vii) ¹	Form of outside director Stock Option Agreement for the Potlatch Corporation 1995 Stock Incentive Plan together with the Addendum thereto as used for options granted in December 1999 and 2000.
(10)(o)*	Credit Agreement, dated as of June 29, 2004, filed as Exhibit 1, to the Current Report on Form 8-K filed July 7, 2004.
(10)(o)(i)	Consent, dated October 15, 2004, whereby the banks participating in the Credit Agreement filed as Exhibit (10)(o) consented to a special cash dividend and a stock repurchase plan.
(10)(p) ¹ *	Form of Performance Share Agreement for the Potlatch Corporation 2000 Stock Incentive Plan, together with the Addendum thereto as used for performance share awards granted in December, 2003 and 2004, filed as Exhibit (10)(q) to the 2003 Form 10-K.
(12)	Computation of Ratio of Earnings to Fixed Charges.
(21)	Potlatch Corporation Subsidiaries.
(23)	Consent of Independent Registered Public Accounting Firm.
(24)	Powers of Attorney.
(31)	Rule 13a-14(a)/15d-14(a) Certifications.
(32)	Furnished statements of the Chief Executive Officer and Chief Financial Officer under 18 U.S.C. Section 1350.
*	Incorporated by reference.
¹	Management compensatory plan or arrangement.
²	Management contract.

Potlatch Corporation
MANAGEMENT PERFORMANCE AWARD PLAN

Adopted: July 20, 1973
Last Amended: December 2, 2004

Potlatch Corporation
MANAGEMENT PERFORMANCE AWARD PLAN

1. ESTABLISHMENT AND PURPOSE

The Potlatch Corporation Management Performance Award Plan (the “Plan”) was adopted on July 20, 1973, by the Board of Directors of Potlatch Corporation to provide meaningful financial rewards to those employees of Potlatch Corporation and its subsidiaries who are in a position to contribute to the achievement by Potlatch Corporation and its subsidiaries of significant improvements in profit performance and growth.

2. DEFINITIONS

- a) “Potlatch” means Potlatch Corporation, a Delaware corporation.
- b) “Subsidiary” means any corporation fifty percent (50%) or more of the voting stock of which is owned by Potlatch or by one or more of such corporations.
- c) “Company” means Potlatch and its Subsidiaries.
- d) “Board of Directors” means the Board of Directors of Potlatch.
- e) “Chairman” means the Chairman of the Board of Potlatch.
- f) “Committee” means the committee which shall administer the Plan in accordance with Section 3.
- g) “Employee” means a full-time salaried employee (including any Officer) of the Company.
- h) “Organization Unit” means a major organizational component or profit center of the Company as determined pursuant to rules and regulations adopted by the Committee from time to time whose Employees are eligible to participate in the Plan.
- i) “Officer” means any Employee who is an elected officer of the Company and who is the chief manager of an Organizational Unit.
- j) “Award” means an award under the Plan.
- k) “Participant” means any Employee actively employed by the Company during an Award Year in an Organization Unit in a position designated as a participating position pursuant to rules and regulations adopted by the Committee from time to time.
- l) “Year” means the calendar year.
- m) “Award Year” means a Year with respect to which Awards are made.

3. ADMINISTRATION OF THE PLAN

The Plan shall be administered by the Executive Compensation and Personnel Policies Committee of the Board of Directors, or such other committee as may be designated and appointed by the Board of Directors, which shall consist of at least three (3) members of the Board of Directors. No member of the Committee shall be eligible to participate and receive Awards under the Plan while serving as a member of the Committee.

In addition to the powers and duties otherwise set forth in the Plan, the Committee shall have full power and authority to administer and interpret the Plan, to establish procedures for administering the Plan, to adopt and periodically review such rules and regulations consistent with the terms of the Plan as the Committee deems necessary or advisable in

order to properly carry out the provisions of the Plan, to receive and review an annual report to be submitted by the Chairman which shall describe and evaluate the operation of the Plan, and to take any and all necessary action in connection therewith. The Committee's interpretation and construction of the Plan and its determination of the amount of any Award thereunder shall be conclusive and binding on all persons. In making such determinations, the Committee is entitled to rely on information and reports provided by the Chairman.

4. ELIGIBILITY AND PARTICIPATION

Pursuant to rules and regulations adopted by the Committee, the Committee shall designate the Organization Units and the positions that are eligible to participate in the Plan.

5. AWARDS

Awards shall be determined in accordance with Sections 6, 7 and 8 and announced to Participants by April 15 following the close of the Award Year.

6. DETERMINING THE ACTUAL CORPORATE FUND

The total amount of Awards made to all Participants with respect to any Award Year shall be determined pursuant to this section.

- a) *Standard Bonus Fund* . There shall first be determined the Standard Bonus Fund for such Award Year. The Standard Bonus Fund shall be computed as follows:
 - i) The Standard Bonus for each Participant shall first be determined. A Participant's Standard Bonus shall be an amount equal to a percentage of the Participant's salary, based on the position to which the Participant is assigned, as determined in accordance with rules and regulations adopted by the Committee. If a Participant does not qualify as a Participant for the entire period of the applicable Award Year, the Standard Bonus will be prorated to reflect the number of full calendar months that the Employee was a Participant.
 - ii) The sum of the Standard Bonuses for all Participants as determined under subparagraph (i) above shall constitute the amount of the Standard Bonus Fund.
 - iii) The Standard Bonus Fund for each Organization Unit shall be the sum of all Standard Bonuses for all Participants in such Organization Unit.
- b) *Performance Modifier* . The Performance Modifiers for each Award Year shall be a percentage determined pursuant to rules and regulations adopted by the Committee. Modifiers may range from a minimum of zero to a maximum of two hundred percent (200%). In its rules and regulations concerning the determination of the Performance Modifiers, the Committee may take into consideration certain financial measures of profit performance (including, without limitation, consolidated earnings per share, return on shareholder equity, return on invested capital) and a comparison of the Company's profit performance with the profit performance of other major competitors).

- c) *Actual Corporate Fund* . The Actual Corporate Fund for each Award Year shall be determined in accordance with rules and regulations adopted by the Committee. The Actual Corporate Fund shall be represented by a bookkeeping entry only and no Employee of the Company shall have any vested right therein.
- d) *Limits on Award Payments* . Notwithstanding any other provision of the Plan, the Board of Directors may, in its sole discretion, determine limits on the amount and alter the time and form of payment of Awards with respect to an Award Year if any of the following conditions occurs: (i) Potlatch does not declare cash dividend with respect to its common stock during such Award Year, or (ii) the Actual Corporate Fund determined pursuant to Section 6(c) for such Award Year exceeds four percent (4%) {six percent (6%) effective January 1, 2005} of Potlatch's consolidated net earnings, before taxes, for such Award Year.

7. ALLOCATING THE ACTUAL CORPORATE FUND AMONG ORGANIZATION UNITS

The Actual Corporate Fund shall be allocated for each Award Year among the Organization Units in accordance with the Plan's rules and regulations.

8. DETERMINING INDIVIDUAL AWARDS

Each Officer shall determine the amount of the Award to each Participant who is assigned to such Officer's Organization Unit (except the Officer's own Award) by prescribing the basis for allocating such Organization Unit's portion of the Actual Corporate Fund among the Participants employed in such Organization Unit, taking into account the amount of the Participant's Standard Bonus and the Participant's individual performance. Each Participant's Award shall be subject to review by and approval of the Chairman.

9. FORM AND TIME OF PAYMENT OF AWARDS

- a) All non-deferred Awards under the Plan earned on and after January 1, 2004, shall be paid in cash to all participants other than those subject to the Company's Stock Ownership Guidelines. For a participant subject to the Guidelines, the award will be paid in a combination of 50% cash and 50% stock if the participant has not incrementally reached the required ownership level at the end of each of his/her first five years under the Guidelines or has not maintained 100% of the applicable guideline amount in subsequent years. The number of shares of common stock shall be determined by dividing the dollar value of the portion of the Award allocated as stock by the closing price of the Company's common stock on the date of the Committee meeting at which the Award payments are approved; Award amounts shall be prorated for the portion of the Award Year the Employee was an eligible Participant pursuant to the rules and regulations adopted by the Committee from time to time. A Participant who is dismissed shall be entitled to receive an Award only to the extent permitted pursuant to the rules adopted by the Committee.
- b) Notwithstanding the foregoing, a Participant may elect to defer receipt of payment of a single Award or all future Awards until after termination of employment pursuant to rules and regulations adopted by the Committee. However, if the payment of the Award would cause the Participant's annual compensation to exceed the amount

deductible under the Internal Revenue Code, the Participant will be required to defer receipt of the portion of the Award that would be non-deductible in the Award Year until after termination of employment. Such rules and regulations shall establish procedures for the Committee, at its discretion, to accelerate the schedule of payments for deferred Awards.

- c) The Award, the payment of which is deferred under (b) above, shall be converted at the Participant's election into cash and or full and fractional stock units equal to the number of shares the Participant would have received if the Award had not been deferred.

On each dividend payment date, dividend equivalents shall be credited to each full and fractional stock unit to the extent such stock unit was in the Participant's deferred account on the dividend record date immediately preceding the applicable dividend payment date. Such dividend equivalents shall be converted into stock units as of the dividend payment date by dividing the amount of the dividend equivalents by the closing price of the Company's common stock on the dividend payment date.

In the event of a change in the number of outstanding shares of the Company's common stock by reason of a stock split, stock dividend, reclassification or other distribution of shares or other similar changes in the capitalization of the Company, an appropriate adjustment shall be made in the number of each Participant's stock units determined as of the date of such occurrence.

- d) The cash portion of an Award, the payment of which was deferred under (b) above shall be credited with additional amounts during the period of deferral commencing on the first day of the month coinciding with or next following the date Awards are normally paid pursuant to Paragraph (a) above, and continuing during the period of deferral up to the last day of the month in which the amounts deferred hereunder are paid, and payable at the time that the deferred Awards are paid. Such additional amounts shall be computed at seventy percent (70%) of the higher of the following averages during the period of deferral; (i) the prime rate charged by the major commercial banks as of the first business day of each calendar month (as reported in an official publication of the Federal Reserve System), or (ii) the average monthly long-term rate of A rated corporate bonds (as published in Moody's Bond Record), and shall be compounded annually. Notwithstanding the foregoing, in no event shall such additional amount exceed the maximum interest rate allowable by law.

10. SPECIAL AWARDS FUND

- a) *Creation of the Fund* . A Special Awards Fund shall be established with respect to each Award Year in an amount determined by the Committee but not to exceed ten percent (10%) of the Standard Bonus Fund for such Award Year. The Special Awards Fund shall be represented by a bookkeeping entry only and no Employee of the Company shall have any vested right therein.
- b) *Eligibility* . Awards may be made in a total amount equal to the Special Awards Fund to those Employees of the Company who are not Participants with respect to such Award Year, but who in the judgment of an Officer have made outstanding contributions to the success of the Company.

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- c) *Selection* . After the close of the Award Year, recipients of Awards under the Special Awards Fund shall be selected by the Chairman upon the recommendation of an Officer. The amount of each individual's Award under the Special Awards Fund shall be determined by the Chairman upon the recommendation of an Officer and shall fall within a range set forth in rules and regulations adopted by the Committee, expressed as minimum and maximum percentages of base annual salary paid. Awards under the Special Awards Fund shall be announced by April 15 following the Award Year.
 - d) *Payment*. Awards under the Special Awards Fund shall be paid in full in cash at the time the Award is announced or as soon as reasonably practicable thereafter.

11. NO ASSIGNMENT OF INTEREST

The interest of any person in the Plan or in payments to be received pursuant to it shall not be subject to option or assignable either by voluntary or involuntary assignment or by operation of law, and any act in violation of this section shall be void.

12. EMPLOYMENT RIGHTS

The selection of an Employee as a Participant shall not confer any right on such Employee to receive an Award under the Plan or to continue in the employ of the Company or limit in any way the right of the Company to terminate such Participant's employment at any time.

13. AMENDMENT OR TERMINATION OF THE PLAN

The Board of Directors may amend, suspend or terminate the Plan at any time; provided, however, that any amendment adopted or effective on or after July 1, in any Award Year which would adversely affect the calculation of a Participant's Award or the Participant's eligibility for an Award for such Award Year shall be applied prospectively from the date the amendment was adopted or effective, whichever is later; provided, further that if the Plan is terminated effective on or after July 1 in any Award Year such termination shall not adversely affect any Participant's eligibility for a pro rata share of an Award for the period of such Award Year prior to the date the termination was adopted or effective, whichever is later, subject to all other applicable terms and conditions of the Plan. In the event of termination of the Plan, Awards deferred under Section 9(b) shall be paid at such times and in such amounts as provided in section 9(b) and the rules and regulations adopted by the Committee.

POTLATCH CORPORATION
2000 STOCK INCENTIVE PLAN

1. PURPOSE .

This Potlatch Corporation 2000 Stock Incentive Plan is intended to provide incentive to employees and directors of Potlatch Corporation (the "Corporation") and its eligible subsidiaries, to encourage proprietary interest in the Corporation and to encourage employees and directors to remain in the service of the Corporation or its subsidiaries.

2. DEFINITIONS .

(a) "Award" means any award of an Option, Restricted Stock or an Other Share-Based Award under the Plan.

(b) "Board" means the Board of Directors of the Corporation.

(c) "Code" means the Internal Revenue Code of 1986, as amended.

(d) "Committee" means the Committee appointed by the Board in accordance with Section 4.

(e) "Common Stock" means the \$1 par value common stock of the Corporation.

(f) "Corporation" means Potlatch Corporation, a Delaware corporation.

(g) "Director" means a director of the Corporation.

(h) "Disability" means the condition of an Employee who is unable to engage in any substantial gainful activity by reason of any medically

determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of at least 12 months.

(i) “ Employee ” means an individual (who may be an officer or a Director) employed by the Corporation or a Subsidiary (within the meaning of the Code section 3401 and the regulations thereunder).

(j) “ Exercise Price ” means the price per Share of Common Stock at which an option may be exercised.

(k) “ Fair Market Value ” of a Share as of a specified date means the closing price at which Shares are traded at the close of business on such date as reported in the New York Stock Exchange composite transactions published in the Western Edition of the Wall Street Journal, or if no trading of Shares is reported for that day, on the next preceding day on which trading was reported.

(l) “ Incentive Stock Option ” means an Option described in Code section 422(b).

(m) “ Misconduct ” means that a Participant has engaged in unfair competition with the Corporation or a Subsidiary, induced any customer of the Corporation or a Subsidiary to breach any contract with the Corporation or a Subsidiary, made any unauthorized disclosure of any of the secrets or confidential information of the Corporation or a Subsidiary, committed an act of embezzlement, fraud or theft with respect to the property of the Corporation or a Subsidiary, or engaged in conduct which is not in good faith and which directly results in material loss, damage or injury to the business, reputation or employees of the Corporation or a Subsidiary.

(n) “ Nonqualified Stock Option ” means an Option not described in Code section 422(b) or 423(b).

(o) “ Option ” means a stock option granted pursuant to Section 7 or Section 10. “ Option Agreement ” means the agreement between the Corporation and the Participant which contains the terms and conditions pertaining to such Option.

(p) “ Other Share-Based Award ” means an Award granted pursuant to Section 9. “ Other Share-Based Award Agreement ” means the agreement between the Corporation and the recipient of an Other Share-Based Award which contains the terms and conditions pertaining to the Other Share-Based Award.

(q) “ Outside Director ” means a Director who is not an Employee.

(r) “ Participant ” means an Employee who has received an Award or an Outside Director who has received an Option.

(s) “ Plan ” means this Potlatch Corporation 2000 Stock Incentive Plan.

(t) “ Purchase Price ” means the Exercise Price times the number of whole Shares with respect to which an Option is exercised.

(u) “ Restricted Stock ” means Shares granted pursuant to Section 8. “ Restricted Stock Agreement ” means the agreement between the Corporation and the recipient of Restricted Stock which contains the terms, conditions and restrictions pertaining to the Restricted Stock.

(v) “ Share ” means one share of Common Stock, adjusted in accordance with Section 13 (if applicable).

(w) “ Stock Right ” means a bookkeeping entry representing a right to the equivalent of one Share.

(x) “ Subsidiary ” means any corporation in an unbroken chain of corporations beginning with the Corporation if each of the corporations

other than the last corporation in the unbroken chain owns stock possessing 50% or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

3. EFFECTIVE DATE.

This Plan was adopted by the Board on December 2, 1999, to be effective immediately, subject to approval by the Corporation's stockholders.

4. ADMINISTRATION.

The Plan shall be administered by a committee (the "Committee") appointed by the Board, consisting of not less than two disinterested members. The term "disinterested members" as applied to Directors shall include only Directors who are not active Employees of the Corporation or of any of its Subsidiaries, who are not eligible to receive discretionary Awards under Sections 7, 8 and 9 of this Plan or under any other stock incentive plan of the Corporation and who have not received such discretionary Awards for at least one year preceding appointment as a member of the Committee. The Board may from time to time remove members from, or add members to, the Committee. Vacancies on the Committee shall be filled by the Board. The Board shall appoint one of the members of the Committee as Chairman.

If any member of the Committee does not qualify as an "outside director" for purposes of section 162(m) of the Code, Awards under the Plan for the chief executive officer and the four most highly compensated officers of the Corporation (other than the chief executive officer) shall be administered by a subcommittee consisting of each Committee member who qualifies as an "outside director." If fewer than two Committee members qualify as "outside directors," the Board shall appoint one or

more other members to such subcommittee who do qualify as “outside directors” so that it will at all times consist of at least two members who qualify as “outside directors” for purposes of section 162(m) of the Code.

The Committee shall hold meetings at such times and places as it may determine. Acts of a majority of the Committee at which a quorum is present, or acts reduced to or approved in writing by a majority of the Committee, shall be the valid acts of the Committee. The Committee shall from time to time at its discretion make determinations with respect to Employees who shall be granted Awards, the number of Shares or Share equivalents to be subject to each Award, the vesting of Awards, the designation of Options as Incentive Stock Options or Nonqualified Stock Options and other conditions of Awards to Employees.

The interpretation and construction by the Committee of any provisions of the Plan or of any Award shall be final. No member of the Committee shall be liable for any action or determination made in good faith with respect to the Plan or any Award.

5. ELIGIBILITY.

Participants shall be such key Employees (who may be officers, whether or not they are Directors) of the Corporation or of its Subsidiaries as the Committee shall select, but subject to the terms and conditions set forth below. In addition, all Outside Directors shall be Participants solely for purposes of the nondiscretionary Awards described in Section 10.

(a) Ten Percent Stockholders .

An Employee who owns more than 10% of the total combined voting power of all classes of outstanding stock of the Corporation, its parent or any

of its Subsidiaries is not eligible to receive an Incentive Stock Option pursuant to this Plan. For purposes of this Section 5(a) the stock ownership of an Employee shall be determined pursuant to section 424(d) of the Code.

(b) Number of Awards.

A Participant may receive more than one Award, including Awards of the same type, but only on the terms and subject to the restrictions set forth in the Plan. The maximum aggregate number of Shares or Share equivalents that may be subject to Awards to a Participant in any calendar year is 100,000 shares.

6. STOCK.

The stock subject to Options, Restricted Stock, or Other Share-Based Awards granted under the Plan shall be Shares of the Corporation's authorized but unissued or reacquired Common Stock. The aggregate number of Options, Restricted Stock or Other Share-Based Awards issued under this Plan shall not exceed 1,400,000 Shares. In the event that any outstanding Option under the Plan for any reason expires or is terminated or any Restricted Stock or Other Share-Based Award is forfeited, the Shares allocable to the unexercised portion of such Option or the forfeited Restricted Stock or Other Share-Based Award may again be subjected to Options, Restricted Stock or Other Share-Based Awards under the Plan, provided that under the terms of the Award the Participant received no benefits of ownership during the period the Award was outstanding. However, if one Award is granted in tandem with another, so that the exercise of one causes the other to expire, then the number of Shares subject to the expired Award shall not be restored to the pool available for Awards.

The limitations established by this Section 6 shall be subject to adjustment as provided in Section 13.

7. TERMS AND CONDITIONS OF EMPLOYEE OPTIONS.

Options granted to Employees pursuant to the Plan shall be evidenced by written Option Agreements in such form as the Committee shall determine, subject to the following terms and conditions:

(a) Number of Shares.

Each Option shall state the number of Shares to which it pertains and shall provide for the adjustment of such number in accordance with Section 13.

(b) Exercise Price.

Each Option shall state the Exercise Price, determined by the Committee, which shall not be less than the Fair Market Value of a Share on the date of grant.

(c) Medium and Time of Payment.

The Purchase Price shall be payable in full in United States dollars upon the exercise of the Option; provided that with the consent of the Committee and in accordance with its rules and regulations, the Purchase Price may be paid by the surrender of Shares in good form for transfer, owned by the person exercising the Option and having a Fair Market Value on the date of exercise equal to the Purchase Price, or in any combination of cash and Shares, so long as the total of the cash and the Fair Market Value of the Shares surrendered equals the Purchase Price. No Share shall be issued until full payment has been made.

(d) Term and Exercise of Options; Nontransferability of Options.

Each Option shall state the time or times when it becomes exercisable. No Option shall be exercisable after the expiration of 10 years from the date it is granted. During the lifetime of the Participant, the Option shall be exercisable only by the Participant and shall not be assignable or transferable. In the event of the Participant's death, no Option shall be transferable by the Participant other than by will or the laws of descent and distribution.

Subject to the foregoing, beginning six months after the date of grant the Participant shall have the right to exercise the Option (or to call the related stock appreciation right as described in Section 7 (i)) in whole or in part:

(i) Upon consummation of a reorganization, merger or consolidation involving the Corporation (a "Business Combination"), in each case, unless, following such Business Combination, (A) all or substantially all of the individuals and entities who were the beneficial owners, respectively, of the then outstanding shares of Common Stock (the "Outstanding Common Stock") and then outstanding voting securities of the Corporation entitled to vote generally in the election of Directors (the "Outstanding Voting Securities") immediately prior to such Business Combination beneficially own, directly or indirectly, more than 50% of, respectively, the then outstanding shares of common stock and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors of the corporation resulting from such Business Combination (including, without limitation, a corporation which as a result of such transaction owns the Corporation either directly or through one or more

subsidiaries), (B) no Person (as defined in subparagraph (iii) below) (excluding any corporation resulting from such Business Combination or any employee benefit plan (or related trust) sponsored or maintained by the Corporation or such other corporation resulting from such Business Combination) beneficially owns, directly or indirectly, 20% or more of, respectively, the then outstanding shares of common stock of the corporation resulting from such Business Combination or the combined voting power of the then outstanding voting securities of such corporation except to the extent that such ownership is based on the beneficial ownership, directly or indirectly, of Outstanding Common Stock or Outstanding Voting Securities immediately prior to the Business Combination and (C) at least a majority of the members of the board of directors of the corporation resulting from such Business Combination were members of the Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination; provided, however, if the Corporation and the other party to the Business Combination agree that the transaction is to be treated as a pooling of interests for financial reporting purposes, and if the transaction in fact is so treated, then the right to exercise the Option (or to call the related stock appreciation right) shall not be accelerated upon consummation of the Business Combination to the extent that the Corporation's independent accountants and the other party's independent accountants separately determine in good faith that the acceleration would preclude the use of pooling of interests accounting; or

(ii) On the date that individuals who, as of December 2, 1999 constitute the Board (the "Incumbent Board") cease for any reason to

constitute at least a majority of the Board; provided, however, that any individual becoming a Director subsequent to December 2, 1999 whose election, or nomination for election by the Corporation's stockholders, was approved by a vote of at least a majority of the Directors then comprising the Incumbent Board shall be considered as though such individual were a member of the Incumbent Board, but excluding, for this purpose, any such individual whose initial assumption of office occurs as a result of an actual or threatened election contest with respect to the election or removal of Directors, an actual or threatened solicitation of proxies or consents or any other actual or threatened action by, or on behalf of any Person other than the Board; or

(iii) Upon the acquisition after December 2, 1999 by any individual, entity or group (within the meaning of Section 13(d) (3) or 14 (d) (2) of the Securities Exchange Act of 1934, as amended (the "Exchange Act")) (a "Person") of beneficial ownership (within the meaning of Rule 13d-3 promulgated under the Exchange Act) of 20% or more of either (A) the then Outstanding Common Stock or (B) the combined voting power of the Outstanding Voting Securities; provided, however, that the following acquisitions shall not be deemed to be covered by this subsection (iii): (x) any acquisition of Outstanding Common Stock or Outstanding Voting Securities by the Corporation, (y) any acquisition of Outstanding Common Stock or Outstanding Voting Securities by any employee benefit plan (or related trust) sponsored or maintained by the Corporation or (z) any acquisition of Outstanding Common Stock or Outstanding Voting Securities by any corporation pursuant to a transaction which complies with clauses (A), (B) and (C) of subsection (i) of this Section 7(d); or

(iv) Upon the consummation of the sale of all or substantially all of the assets of the Corporation or approval by the stockholders of the Corporation of a complete liquidation or dissolution of the Corporation.

(e) Termination of Employment Except Death.

In the event that a Participant who is an Employee ceases to be employed by the Corporation or its Subsidiaries for any reason other than death, such Participant shall have the right (subject to the limitations of Section 7(d) above) to exercise the Option either:

(i) within three months after such termination of employment; or

(ii) (in the case of Early, Normal or Late Retirement under the Salaried Employees' Retirement Plan, or Disability), at any time before the end of the option period specified in the Option Agreement, to the extent that, at the date of termination of employment, the Option had vested pursuant to the terms of the Option Agreement with respect to which such Option was granted and had not previously been exercised. However, if the employment of a Participant is terminated by the Corporation or a Subsidiary by reason of Misconduct, such Option shall cease to be exercisable at the time of the Participant's termination of employment. The Committee shall determine whether a Participant's employment is terminated by reason of Misconduct. In making such determination the Committee shall act fairly and shall give the Participant an opportunity to be heard and present evidence on his or her behalf. If a Participant's employment terminates for reasons other than Misconduct, but Misconduct is discovered after the termination and is determined to have occurred by the Committee, all outstanding Options shall cease to be exercisable upon such determination.

For purposes of the section, the employment relationship will be treated as continuing while the Participant is on military leave, sick leave or other bona fide leave of absence (to be determined in the sole discretion of the Committee, in accordance with rules and regulations construing Code section 422(a)(2)). Notwithstanding the foregoing, in the case of an Incentive Stock Option, employment shall not be deemed to continue beyond the 90th day after the Participant ceased active employment, unless the Participant's reemployment rights are guaranteed by statute or by contract.

(f) Death of Participant.

If a Participant who is an Employee dies while in the employ of the Corporation or a Subsidiary, the Option may be exercised at any time before the end of the option period as specified in the Option Agreement by the executors or administrators of the Participant's estate or by any person or persons who acquired the Option directly from the Participant by bequest or inheritance, to the extent that, at the date of the Participant's death, the Option had vested pursuant to the terms of the Option Agreement and had not previously been exercised.

(g) Rights as a Stockholder.

A Participant or a transferee of a Participant shall have no rights as a stockholder with respect to any Shares covered by his or her Option until the date of issuance of a stock certificate for such Shares. No adjustment shall be made for dividends, distributions or other rights for which the record date is prior to the date such stock certificate is issued, except as provided in Section 13.

(h) Modification, Extension and Renewal of Options.

Subject to the terms and conditions and within the limitations of the Plan, the Committee may modify, extend or renew outstanding Options granted

to Employees under the Plan, or accept the exchange of outstanding Options (to the extent not previously exercised) for the granting of new Options (at the same or a different price). Notwithstanding the foregoing, however, no modification of an Option shall, without the consent of the Participant, alter or impair any rights or obligations under any Option previously granted under the Plan.

(i) Stock Appreciation Rights.

Each Option granted under the Plan shall include a stock appreciation right that may be exercised only following the applicable event described in Section 7(d)(i) through (iv). Following any such event, the Participant shall have the right to surrender all or part of the Option and to exercise the stock appreciation right (the “call”) to obtain payment from the Corporation of an amount equal to the difference obtained by subtracting the aggregate Exercise Price of the Shares subject to the Option (or the portion of such Option) surrendered from the Fair Market Value of such Shares on the date of such surrender. In the case of a stock appreciation right called after an event described in Section 7(d) (i) or (iv) above, “Fair Market Value” for purposes of this Subsection (i) shall be the greater of (A) the Fair Market Value of such Shares as of the date immediately prior to the event described in Section 7(d) (i) or (iv) above, or (B) the value of such Shares determined as of the date of the call in good faith by the Committee (as composed on the day preceding the date of the event described in Section 7(d) (i) or (iv) above), taking into consideration all relevant facts and circumstances. The call of such stock appreciation right shall be subject to such limitations (including, but not limited to, limitations as to time and amount) as the Committee shall deem appropriate. The payment may be made in shares of Common Stock (determined with reference to its Fair Market Value on the

date of call), or in cash, or partly in cash and in shares of Common Stock, at the discretion of the Committee, provided that the Committee determines that such settlement is consistent with the purpose set forth in Section 1, and provided further, that if the stock appreciation right is called after an event described in Section 7(d)(i) or (iv), the payment shall be made in cash. For all purposes under the Plan, the terms “exercise” or “exercisable” shall be deemed to include the terms “call” or “callable” as such terms may apply to a stock appreciation right, and in the event of the call of a stock appreciation right, the underlying Option will be deemed to have been exercised for all purposes under the Plan.

(j) Limitation of Incentive Stock Option Awards .

If and to the extent that the aggregate Fair Market Value (determined as of the date the Option is granted) of the Shares with respect to which any Incentive Stock Options are exercisable for the first time by a Participant during any calendar year under this Plan and all other plans maintained by the Corporation, its parent or its Subsidiaries exceeds \$100,000, the excess (taking into account the order in which they were granted) shall be treated as nonqualified stock options.

(k) Other Provisions .

The Option Agreement shall contain such other provisions that are consistent with the terms of the Plan, including, without limitation, restrictions upon the exercise of the Option, as the Committee shall deem advisable.

8. RESTRICTED STOCK.

(a) Grants.

Subject to the provisions of the Plan, the Committee shall have sole and complete authority to determine the Employees to whom, and the time or times at which, grants of Restricted Stock will be made, the number of shares of Restricted Stock to be awarded, the price (if any) to be paid by the recipient of Restricted Stock, the time or times within which such Awards may be subject to forfeiture, and all other terms and conditions of the Awards. The Committee may condition the grant of Restricted Stock upon the attainment of specified performance goals or such other factors as the Committee may determine, in its sole discretion.

The terms of each Restricted Stock Award shall be set forth in a Restricted Stock Agreement between the Corporation and the Employee, which Agreement shall contain such provisions as the Committee determines to be necessary or appropriate to carry out the intent of the Plan. Each Participant receiving a Restricted Stock Award shall be issued a stock certificate in respect of such shares of Restricted Stock. Such certificate shall be registered in the name of such Participant, and shall bear an appropriate legend referring to the terms, conditions, and restrictions applicable to such Award. The Committee shall require that stock certificates evidencing such shares be held by the Corporation until the restrictions lapse and that, as a condition of any Restricted Stock Award, the Participant shall deliver to the Corporation a stock power relating to the stock covered by such Award.

(b) Restrictions and Conditions.

The shares of Restricted Stock awarded pursuant to this Section 8 shall be subject to the following restrictions and conditions:

(i) During a period set by the Committee commencing with the date of such Award (the "Restriction Period"), the Participant shall not be permitted to sell, transfer, pledge, assign or encumber shares of Restricted Stock awarded under the Plan. Within these limits, the Committee, in its sole discretion, may provide for the lapse of such restrictions in installments and may accelerate or waive such restrictions in whole or in part, based on service, performance, a change of control of the Corporation or such other factors or criteria as the Committee may determine in its sole discretion.

(ii) Except as provided in this paragraph (ii) and paragraph (i) above, the Participant shall have, with respect to the shares of Restricted Stock, all of the rights of a stockholder of the Corporation, including the right to vote the shares and the right to receive any cash dividends. The Committee, in its sole discretion, as determined at the time of Award, may provide that the payment of cash dividends shall or may be deferred and, if the Committee so determines, reinvested in additional Shares of Restricted Stock to the extent available under Section 6, or otherwise reinvested. Stock dividends issued with respect to Restricted Stock shall be treated as additional shares of Restricted Stock that are subject to the same restrictions and other terms and conditions that apply to the shares with respect to which such dividends are issued.

(iii) The Committee shall specify the conditions under which shares of Restricted Stock shall vest or be forfeited and such conditions shall be set forth in the Restricted Stock Agreement.

(iv) If and when the Restriction Period applicable to shares of Restricted Stock expires without a prior forfeiture of the Restricted Stock, certificates for an appropriate number of unrestricted Shares shall be delivered promptly to the Participant, and the certificates for the shares of Restricted Stock shall be canceled.

9. OTHER SHARE-BASED AWARDS .

(a) Grants .

Other Awards of Shares and other Awards that are valued in whole or in part by reference to, or are otherwise based on, Shares ("Other Share-Based Awards"), may be granted either alone or in addition to or in conjunction with other Awards under this Plan. Awards under this Section 9 may include (without limitation) Stock Rights, the grant of Shares conditioned upon some specified event, the payment of cash based upon the performance of the Shares or the grant of securities convertible into Shares.

Subject to the provisions of the Plan, the Committee shall have sole and complete authority to determine the Employees to whom and the time or times at which Other Share-Based Awards shall be made, the number of Shares or other securities, if any, to be granted pursuant to Other Share-Based Awards, and all other conditions of the Other Share-Based Awards. The Committee may condition the grant of an Other Share-Based Award upon the attainment of specified performance goals or such other factors as the Committee shall determine, in its sole discretion. In making an Other

Share-Based Award, the Committee may determine that the recipient of an Other Share-Based Award shall be entitled to receive, currently or on a deferred basis, interest or dividends or dividend equivalents with respect to the Shares or other securities covered by the Award, and the Committee may provide that such amounts (if any) shall be deemed to have been reinvested in additional Shares or otherwise reinvested. The terms of any Other Share-Based Award shall be set forth in an Other Share-Based Award Agreement between the Corporation and the Employee, which Agreement shall contain such provisions as the Committee determines to be necessary or appropriate to carry out the intent of the Plan.

(b) Terms and Conditions .

In addition to the terms and conditions specified in the Other Share-Based Award Agreement, Other Share-Based Awards shall be subject to the following:

(i) Any Other Share-Based Award may not be sold, assigned, transferred, pledged or otherwise encumbered prior to the date on which the Shares are issued or the Award becomes payable, or, if later, the date on which any applicable restriction, performance or deferral period lapses.

(ii) The Other Share-Based Award Agreement shall contain provisions dealing with the disposition of such Award in the event of termination of the Employee's employment prior to the exercise, realization or payment of such Award, and the Committee in its sole discretion may provide for payment of the Award in the event of the Employee's retirement, Disability or death or the change of control of the Corporation, with such provisions to take account of the specific nature and purpose of the Award.

10. OPTION AWARDS TO OUTSIDE DIRECTORS.

(a) Award Upon Election.

Each Outside Director who is elected by the Board to fill a vacancy on the Board shall receive a Nonqualified Stock Option for 5,000 Shares on the date of the Board's regular meeting in December following his or her election.

(b) Annual Awards.

Each Outside Director shall receive a Nonqualified Stock Option for 2,500 Shares on the date of the Board's regular meeting in December of each year he or she serves as Outside Director, other than a year in which the Outside Director receives an award under Section 10(a) above.

(c) Terms and Conditions of Options.

Each Nonqualified Stock Option granted pursuant to this Section 10 shall be subject to the following terms and conditions:

(i) The Exercise Price shall be the Fair Market Value of a Share on the date of grant.

(ii) The Option shall become vested and exercisable in 50% increments on the first and second anniversaries of the date of grant, provided the Outside Director has continuously been an Outside Director from the date of grant until such time.

(iii) In the event the Outside Director terminates services as a Director for any reason other than death, the former Director shall have the right to exercise the Option either:

(A) within three months after such termination,

or

(B) in the case of termination after five years of service as an Outside Director, at any time before the end of the option period specified in the Option Agreement, to the extent that, at the date of termination the Option had vested pursuant to (ii) above and had not previously been exercised. However, if the services of the Outside Director are terminated by the Board for cause in accordance with the Corporation's Restated Certificate of Incorporation, such Option shall cease to be exercisable at the time of the Outside Director's termination of services.

(iv) In the event the Outside Director's services terminate by reason of death, the Option may be exercised at any time before the end of the option period specified in the Option Agreement by the executors or administrators of the Director's estate or by any person or persons who shall have acquired the Option directly from the Director by bequest or inheritance, to the extent that, at the date of the Director's death, the Option had vested pursuant to (ii) above and had not previously been exercised.

Except as specifically set forth in (i) through (iv) above, each Nonqualified Stock Option granted pursuant to this Section 10 also shall be subject to all of the terms and conditions set forth in Section 7, other than Section 7(h).

11. OTHER PAYMENTS IN SHARES.

Shares may be issued under this Plan to satisfy the payment of all or part of an award pursuant to the Potlatch Corporation Management Performance

Award Plan. In addition, all or part of any Director's fees may be paid in Shares issued under this Plan. Any Shares issued pursuant to this Section 11 shall reduce the number of Shares authorized for Options, Restricted Stock or Other Share-Based Awards under Section 6 but shall not be considered an Award for purposes of the maximum grant limitation in Section 5(b).

12. TERM OF PLAN.

Awards may be granted and Shares may be issued pursuant to the Plan until the termination of the Plan on December 2, 2009.

13. RECAPITALIZATION.

Subject to any required action by the stockholders, the number of Shares covered by this Plan as provided in Section 6, the maximum grant limitation in Section 5(b), the number of Shares covered by or referenced in each outstanding Award, the number of Options to be granted to Outside Directors under Sections 10(a) through 10(c) and the Exercise Price of each outstanding Option and any price required to be paid for Restricted Stock or Other Share-Based Award shall be proportionately adjusted for any increase or decrease in the number of issued Shares resulting from a subdivision or consolidation of Shares, the payment of a stock dividend (but only of Common Stock) or any other increase or decrease in the number of such Shares effected without receipt of consideration by the Corporation or the declaration of a dividend payable in cash that has a material effect on the price of issued Shares.

Subject to any required action by the stockholders, if the Corporation shall be a party to any merger, consolidation or other reorganization, each

outstanding Award shall pertain and apply to the securities to which a holder of the number of Shares subject to the Award would have been entitled. In the event of a change in the Common Stock as presently constituted, which is limited to a change of all of its authorized shares with par value into the same number of shares with a different par value or without par value, the shares resulting from any such change shall be deemed to be the Common Stock within the meaning of the Plan.

To the extent that the foregoing adjustments relate to stock or securities of the Corporation, such adjustments shall be made by the Committee, whose determination in that respect shall be final, binding and conclusive, provided that each Incentive Stock Option granted pursuant to this Plan shall not be adjusted in a manner that causes the Option to fail to continue to qualify as an incentive stock option within the meaning of section 422 of the Code.

Except as expressly provided in this Section 13, a Participant shall have no rights by reason of any subdivision or consolidation of shares of stock of any class or the payment of any stock dividend or any other increase or decrease in the number of shares of stock of any class or by reason of any dissolution, liquidation, merger or consolidation or spin-off of assets or stock of another corporation, and any issue by the Corporation of shares of stock of any class or securities convertible into shares of stock of any class, shall not affect the number or price of Shares subject to the Option.

The grant of an Option pursuant to the Plan shall not affect in any way the right or power of the Corporation to make adjustments, reclassifications, reorganizations or changes of its capital or business structure or to merge or consolidate or to dissolve, liquidate, sell or transfer all or any part of its business assets.

14. SECURITIES LAW REQUIREMENTS AND LIMITATION OF RIGHTS.

(a) Securities Law.

No Shares shall be issued pursuant to the Plan unless and until the Corporation has determined that: (i) it and the Participant have taken all actions required to register the Shares under the Securities Act of 1933 or perfect an exemption from registration; (ii) any applicable listing requirement of any stock exchange on which the Common Stock is listed has been satisfied; and (iii) any other applicable provision of state or federal law has been satisfied.

(b) Employment Rights.

Neither the Plan nor any Award granted under the Plan shall be deemed to give any individual a right to remain employed by the Corporation or a Subsidiary or to remain a Director. The Corporation and its Subsidiaries reserve the right to terminate the employment of any employee at any time, with or without cause or for no cause, subject only to a written employment contract (if any), and the Board reserves the right to terminate a Director's membership on the Board for cause in accordance with the Corporation's Restated Certificate of Incorporation.

(c) Stockholders' Rights.

A Participant shall have no dividend rights, voting rights or other rights as a stockholder with respect to any Shares covered by his or her Award prior to the issuance of a stock certificate for such Shares. No adjustment shall be made for cash dividends or other rights for which the record date is prior to the date when such certificate is issued.

(d) Creditors' Rights.

A holder of an Other Share-Based Award shall have no rights other than those of a general creditor of the Corporation. An Other Share-Based Award shall represent an unfunded and unsecured obligation of the Corporation, subject to the terms and conditions of the applicable Other Share-Based Award Agreement. An Other Share-Based Award shall not be deemed to create a trust for the benefit of any individual.

15. AMENDMENT OF THE PLAN.

The Board may suspend or discontinue the Plan or revise or amend it with respect to any Shares at the time not subject to Awards except that, without approval of the stockholders of the Corporation, no such revision or amendment shall:

- (a) Increase the number of Shares subject to the Plan;
- (b) Change the designation in Section 5 of the class of Employees eligible to receive Awards;
- (c) Decrease the price at which Incentive Stock Options may be granted;
- (d) Remove the administration of the Plan from the Committee;
- (e) Render any disinterested member of the Committee eligible to receive a discretionary Award under Sections 7, 8 and 9 while serving on the Committee;
- (f) Amend this Section 15 to defeat its purpose.

16. NO OBLIGATION TO EXERCISE OPTION.

The granting of an Option shall impose no obligation upon the Participant to exercise such Option.

17. APPROVAL OF STOCKHOLDERS.

This Plan and any amendments requiring stockholder approval pursuant to Section 15 shall be subject to approval by affirmative vote of the stockholders. Such vote shall be taken at the first annual meeting of stockholders of the Corporation following the adoption of the Plan or of any such amendments, or any adjournment of such meeting.

18. PAYMENT OF EXCISE TAX.

If any payments or transfers to or for the benefit of the Participant are deemed an “excess parachute payment” as defined in Section 280G of the Internal Revenue Code of 1986 (the “Code”) subject to the excise tax imposed by Section 4999 of the Code, the Corporation shall pay to the Participant an additional amount such that the total amount of all such payments and benefits (including payments made pursuant to this Section) to the Participant shall equal the total amount of all such payments and benefits to which the Participant would have been entitled (but for this Section) net of all applicable federal, state and local taxes except the excise tax. For purposes of this Section, the Participant shall be deemed to pay federal, state and local taxes at the highest marginal rate of taxation for the applicable calendar year. The amount of the payment to the Participant shall be estimated by the firm of independent certified public accountants serving as the outside auditor of the Corporation, as of the date of the applicable event as described in Section 7(d) (i) through (iv).

19. WITHHOLDING TAXES.

(a) General.

To the extent required by applicable law, the recipient of any payment or distribution under the Plan shall make arrangements satisfactory to the Corporation for the satisfaction of any withholding tax obligations that arise by reason of such payment or distribution. The Corporation shall not be required to make such payment or distribution until such obligations are satisfied.

(b) Nonqualified Options.

The Committee may permit a Participant who exercises Nonqualified Stock Options to satisfy all or part of his or her withholding tax obligations by having the Corporation withhold a portion of the Shares that otherwise would be issued to him or her under such Nonqualified Stock Options. Such Shares shall be valued at their Fair Market Value on the date when taxes otherwise would be withheld in cash. The payment of withholding taxes by surrendering Shares to the Corporation, if permitted by the Committee, shall be subject to such restrictions as the Committee may impose, including any restrictions required by rules of the Securities and Exchange Commission.

20. EXECUTION.

To record the adoption of the Plan effective December 2, 1999, the Corporation has caused its authorized officer to execute the same.

POTLATCH CORPORATION

By /s/ Betty R. Fleshman

**AMENDMENT NO. 1 TO
POTLATCH CORPORATION
2000 STOCK INCENTIVE PLAN**

WHEREAS, the Board of Directors adopted and the stockholders approved the Potlatch Corporation 2000 Stock Incentive Plan (the "Plan"); and

WHEREAS, pursuant to Section 15 of the Plan, the Board of Directors of Potlatch Corporation at its meeting held on December 2, 2004, amended the Plan by deleting Section 10 thereof in its entirety and substituting the notation "Reserved" in lieu of renumbering all subsequent section of the Plan;

THEREFORE, based on the action taken by the Board of Directors of Potlatch Corporation, the Plan is amended as follows:

1. Section 10 of the Plan is deleted and shall read as follows:
"10. RESERVED."
2. Except as amended as set forth herein, The Plan shall continue in full force and effect.

IN WITNESS WHEREOF, to record the adoption of this Amendment No. 1, Potlatch Corporation has caused its authorized officer to execute the same as of the 2nd day of December, 2004.

POTLATCH CORPORATION

By /s/ Barbara Failing

Amendment No. 5
to
Schedule A to Exhibit (10)(k)
February 25, 2005

The following table sets forth the name of each current officer of Potlatch Corporation who has executed the Indemnification Agreement filed as Exhibit (10)(k):

<u>Name of Officer</u>	<u>Position</u>	<u>Date Agreement Executed</u>
L. Pendleton Siegel	Chairman and Chief Executive Officer	December 11, 1986
Terry L. Carter	Controller	January 1, 2003
Ralph M. Davisson	Vice President	April 1, 1990
Robert P. DeVleming	Vice President	October 22, 2004
Christopher A. Eckel	Vice President	February 1, 2005
Richard K. Kelly	Vice President	July 15, 1999
John R. Olson	Vice President	July 30, 1999
Harry D. Seamans	Vice President	January 1, 2003
Gerald L. Zuehlke	Vice President, Finance Chief Financial Officer	April 10, 1995
Malcolm A. Ryerse	Corporate Secretary	August 7, 2000

POTLATCH CORPORATION

1989 STOCK INCENTIVE PLAN

(As Amended and Restated Effective December 2, 1999)

1. PURPOSE.

This 1989 Stock Incentive Plan of Potlatch Corporation (the "Corporation") and its eligible subsidiaries is intended to provide incentive to employees of the Corporation or of its subsidiaries, to encourage employee proprietary interest in the Corporation and to encourage employees to remain in the employ of the Corporation or of its subsidiaries.

2. DEFINITIONS.

(a) "Award" shall mean any award of an Option (with or without a related stock appreciation right), Restricted Stock or an Other Share-Based Award under the Plan.

(b) "Board" shall mean the Board of Directors of the Corporation.

(c) "Code" shall mean the Internal Revenue Code of 1986, as amended.

(d) "Committee" shall mean the Committee appointed by the Board in accordance with Section 4 of the Plan.

(e) "Common Stock" shall mean the \$1 par value common stock of the Corporation.

(f) "Corporation" shall mean Potlatch Corporation, a Delaware corporation.

(g) “ Disability ” shall mean the condition of an Employee who is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than twelve (12) months.

(h) “ Employee ” shall mean an individual (who may be an officer or a director) employed by the Corporation or a Subsidiary (within the meaning of Code section 3401 and the regulations thereunder).

(i) “ Exercise Price ” shall mean the price per Share of Common Stock, determined by the Committee, at which an Option may be exercised.

(j) “ Fair Market Value ” of a Share as of a specified date shall mean the closing price at which such Shares are traded at the close of business on such date as reported in the New York Stock Exchange composite transactions published in the Western Edition of the Wall Street Journal, or if no trading of the Common Stock is reported for that day, on the next preceding day on which trading was reported.

(k) “ Incentive Stock Option ” shall mean an Option described in Code section 422A(b).

(l) “ Nonqualified Stock Option ” shall mean an Option not described in Code sections 422(b), 422A(b), 423(b) or 424(b).

(m) “ Option ” shall mean a stock option granted pursuant to Section 7 of the Plan. “ Option Agreement ” shall mean the agreement between the Corporation and the Optionee which contains the terms and conditions pertaining to such Option.

(n) “ Optionee ” shall mean an Employee who has received an Option.

(o) “ Other Share-Based Award ” shall mean an Award granted pursuant to Section 9 of the Plan. “ Other Share- Based Award Agreement ” shall mean the agreement between the Corporation and the recipient of an Other Share-Based Award which contains the terms and conditions pertaining to such Other Share-Based Award.

(p) “ Participant ” shall mean an Employee who has received an Award.

(q) “ Plan ” shall mean this Potlatch Corporation 1989 Stock Incentive Plan.

(r) “ Purchase Price ” shall mean the Exercise Price times the number of whole Shares with respect to which an Option is exercised.

(s) “ Restricted Stock ” shall mean Shares granted pursuant to Section 8 of the Plan. “ Restricted Stock Agreement ” shall mean the agreement between the Corporation and the recipient of Restricted Stock which contains the terms, conditions and restrictions pertaining to such Restricted Stock.

(t) “ Rules ” shall mean the regulations and rules adopted from time to time by the Committee.

(u) “ Share ” shall mean one Share of Common Stock, adjusted in accordance with Section 11 of the Plan (if applicable).

(v) “ Stock Right ” shall mean a bookkeeping entry representing a right to the equivalent of one Share.

(w) “ Subsidiary ” shall mean any corporation in an unbroken chain of corporations beginning with the Corporation if each of the corporations other than the last corporation in the unbroken chain owns stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

3. EFFECTIVE DATE.

This Plan was adopted by the Board on December 8, 1988, and was last amended and restated effective December 2, 1999.

4. ADMINISTRATION.

The Plan shall be administered by a committee (the “Committee”) appointed by the Board, consisting of not less than three disinterested members thereof. The Board may from time to time remove members from, or add members to,

the Committee. Vacancies on the Committee, howsoever caused, shall be filled by the Board. The Board shall appoint one of the members of the Committee as Chairman. The term “Disinterested Members of the Board” shall include only members of the Board who are not active Employees of the Corporation or of any of its Subsidiaries, who are not eligible to receive discretionary Awards under this Plan or any other stock incentive plan of the Corporation and who have not been eligible to receive such Awards for at least one year preceding appointment as a member of the Committee.

The Committee shall hold meetings at such times and places as it may determine. Acts of a majority of the Committee at which a quorum is present, or acts reduced to or approved in writing by a majority of the members of the Committee, shall be the valid acts of the Committee. The Committee shall from time to time at its discretion make determinations with respect to Employees who shall be granted Awards, the number of Shares or Share equivalents to be subject to each Award, the vesting of Awards, the designation of Options as Incentive Stock Options or Nonqualified Stock Options and other conditions of Awards.

The interpretation and construction by the Committee of any provisions of the Plan or of any Award granted thereunder shall be final. No member of the Committee shall be liable for any action or determination made in good faith with respect to the Plan or any Award granted thereunder.

5. ELIGIBILITY.

Participants shall be such key Employees (who may be officers, whether or not they are directors) of the Corporation or of its Subsidiaries as the Committee shall select, but subject to the terms and conditions set forth below.

(a) Ten Percent Shareholders.

An Employee who owns more than ten percent (10%) of the total combined voting power of all classes of outstanding stock of the Corporation, its parent or any of its Subsidiaries is not eligible to receive an Incentive Stock Option pursuant to this Plan. For purposes of this Section 5(a) the stock ownership of an Employee shall be determined pursuant to section 425(d) of the Code.

(b) Number of Awards.

A Participant may receive more than one Award, including Awards of the same type, but only on the terms and subject to the restrictions hereinafter set forth.

6. STOCK.

The stock subject to Options, Restricted Stock, or Other Share-Based Awards granted under the Plan shall be Shares of the Corporation's authorized but unissued or reacquired Common Stock. The aggregate number of Options, Restricted Stock or Other Share-Based Awards issued under this Plan shall not exceed one million, five hundred thousand (1,500,000) Shares. The number of Shares subject to Awards

outstanding under the Plan at any time may not exceed the number of Shares remaining available for issuance under the Plan. In the event that any outstanding Option under the Plan for any reason expires or is terminated or any Restricted Stock or Other Share-Based Award is forfeited, the Shares allocable to the unexercised portion of such Option or the forfeited Restricted Stock or Other Share-Based Award may again be subjected to Options, Restricted Stock or Other Share-Based Awards under the Plan. However, if one Award is granted in tandem with another, so that the exercise of one causes the other to expire, then the number of shares subject to the expired Award shall not be restored to the pool available for Awards.

The limitations established by this Section 6 shall be subject to adjustment upon the occurrence of the events specified and in the manner provided in Section 11 hereof.

7. TERMS AND CONDITIONS OF OPTIONS.

Options granted pursuant to the Plan shall be evidenced by written Option Agreements in such form as the Committee shall from time to time determine, which agreements shall comply with and be subject to the following terms and conditions:

(a) Optionee's Agreement.

Each Optionee shall agree to remain in the employ of and to render to the Corporation or to a Subsidiary his

or her services for a period of one (1) year from the date of the granting of the Option, subject to the terms of Section 12(b).

(b) Number of Shares .

Each Option shall state the number of Shares to which it pertains and shall provide for the adjustment thereof in accordance with the provisions of Section 11 hereof.

(c) Exercise Price .

Each Option shall state the Exercise Price, which in the case of an Incentive Stock Option shall not be less than the Fair Market Value of a Share on the date of grant.

(d) Medium and Time of Payment .

The Purchase Price shall be payable in full in United States dollars upon the exercise of the Option; provided, however, that, with the consent of the Committee and in accordance with its rules, the Purchase Price may be paid by the surrender of Shares in good form for transfer, owned by the person exercising the Option and having a Fair Market Value on the date of exercise equal to the Purchase Price, or in any combination of cash and Shares, so long as the total of the cash so paid and the Fair Market Value of the Shares surrendered equals the Purchase Price. No Share shall be issued until full payment therefor has been made.

(e) Term and Exercise of Options; Nontransferability of Options.

Each Option shall state the time or times when it becomes exercisable and the time or times any stock appreciation right granted pursuant to Section 7(j) may be called, which shall be determined by the Committee. No Option shall be exercisable after the expiration of ten (10) years from the date it is granted. During the lifetime of the Optionee, the Option shall be exercisable only by the Optionee and shall not be assignable or transferable. In the event of the Optionee's death, no Option shall be transferable by the Optionee otherwise than by will or the laws of descent and distribution.

Subject to the foregoing, beginning six (6) months from the date of grant of the Optionee shall have the right to exercise the option (or in lieu thereof to call the related stock appreciation right as described in Section 7(j)) in whole or in part:

(i) Upon consummation of a reorganization, merger or consolidation involving the Corporation (a "Business Combination"), in each case, unless, following such Business Combination, (A) all or substantially all of the individuals and entities who were the beneficial owners, respectively, of the then outstanding shares of Common Stock (the "Outstanding Common Stock") and then outstanding voting securities of the Corporation entitled

to vote generally in the election of directors (the “Outstanding Voting Securities”) immediately prior to such Business Combination beneficially own, directly or indirectly, more than 50% of, respectively, the then outstanding shares of common stock and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors of the corporation resulting from such Business Combination (including, without limitation, a corporation which as a result of such transaction owns the Corporation either directly or through one or more subsidiaries), (B) no Person (as defined in subparagraph (iii) below) (excluding any corporation resulting from such Business Combination or any employee benefit plan (or related trust) sponsored or maintained by the Corporation or such other corporation resulting from such Business Combination) beneficially owns, directly or indirectly, 20% or more of, respectively, the then outstanding shares of common stock of the corporation resulting from such Business Combination or the combined voting power of the then outstanding voting securities of such corporation except to the extent that such ownership is based on the beneficial ownership, directly or indirectly, of Outstanding Common Stock or Outstanding Voting Securities immediately prior to the Business Combination and (C) at least a majority of the members of the board of directors of the corporation resulting from such Business Combination were members of the Board at the time of the execution of the initial

agreement, or of the action of the Board, providing for such Business Combination, provided, however, if the Corporation and the other party to the Business Combination agree that the transaction is to be treated as a pooling of interests for financial reporting purposes, and if the transaction in fact is so treated, then the right to exercise the Option (or to call the related stock appreciation right) shall not be accelerated upon consummation of the Business Combination to the extent that the Corporation's independent accountants and the other party's independent accountants separately determine in good faith that the acceleration would preclude the use of pooling of interests accounting; or

(ii) On the date that individuals who, as of December 2, 1999 constitute the Board (the "Incumbent Board") cease for any reason to constitute at least a majority of the Board; provided, however, that any individual becoming a director subsequent to December 2, 1999 whose election, or nomination for election by the Corporation's stockholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board shall be considered as though such individual were a member of the Incumbent Board, but excluding, for this purpose, any such individual whose initial assumption of office occurs as a result of an actual or threatened election contest with respect to the election or removal of directors, an actual or threatened solicitation of proxies or consents or any other actual or threatened action by, or on behalf of any Person other than the Board; or

(iii) Upon acquisition after December 2, 1999 by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) (a “Person”) of beneficial ownership (within the meaning of Rule 13d-3 promulgated under the Exchange Act) of 20% or more of either (A) the then Outstanding Common Stock or (B) the combined voting power of the Outstanding Voting Securities; provided, however, that the following acquisitions shall not be deemed to be covered by this subsection (iii): (x) any acquisition of Outstanding Common Stock or Outstanding Voting Securities by the Corporation, (y) any acquisition of Outstanding Common Stock or Outstanding Voting Securities by any employee benefit plan (or related trust) sponsored or maintained by the Corporation or (z) any acquisition of Outstanding Common Stock or Outstanding Voting Securities by any corporation pursuant to a transaction which complies with clauses (A), (B) and (C) of subsection (i) of this Section 7(e); or

(iv) Upon the consummation of the sale of all or substantially all of the assets of the Corporation or approval by the stockholders of the Corporation of a complete liquidation or dissolution of the Corporation.

(f) Termination of Employment Except Death.

Except as provided in Subsection (k) below, in the event that an Optionee shall cease to be employed by the Corporation or its Subsidiaries for any reason other than his or her death, such Optionee shall have the right, subject to the restrictions of Subsection (e) hereof, to exercise the Option either:

(i) at any time within three (3) months after such termination of employment; or

(ii) (in the case of Early, Normal or Late Retirement under the Salaried Employees' Retirement Plan or Disability), at any time before the end of the option period specified in the Option Agreement, to the extent that, at the date of termination of employment, the Optionee's right to exercise such Option had accrued pursuant to the terms of the Option Agreement with respect to which such option was granted and had not previously been exercised; provided, however, that if the employment of an Optionee is terminated by the Corporation or a Subsidiary by reason of misconduct, such Option shall cease to be exercisable at the time of the Optionee's termination of employment. As used herein "misconduct" means that the Optionee has engaged in unfair competition with the Corporation or a Subsidiary, induced any customer

of the Corporation or a Subsidiary to breach any contract with the Corporation or a Subsidiary, made any unauthorized disclosure of any of the secrets or confidential information of the Corporation or a Subsidiary, committed an act of embezzlement, fraud or theft with respect to the property of the Corporation or a Subsidiary, or engaged in conduct which is not in good faith and which directly results in material loss, damage or injury to the business, reputation or employees of the Corporation or a Subsidiary. The Committee shall determine whether an Optionee's employment is terminated by reason of misconduct. In making such determination the Committee shall act fairly and shall give the Optionee an opportunity to be heard and present evidence on his or her behalf.

For this purpose, the employment relationship will be treated as continuing intact while the Optionee is on military leave, sick leave or other bona fide leave of absence (to be determined in the sole discretion of the Committee, in accordance with rules and regulations construing Code section 422A(a)(2)). Notwithstanding the foregoing, in the case of an Incentive Stock Option, employment shall not be deemed to continue beyond the ninetieth (90th) day after the Optionee ceased active employment, unless the Optionee's reemployment rights are guaranteed by statute or by contract.

(g) Death of Optionee.

Except as provided in Subsection (k) below, if the Optionee shall die while in the employ of the Corporation or a Subsidiary and shall not have fully exercised the Option, an Option may be exercised at any time before the end of the option period specified in the Option Agreement by the executors or administrators of the Optionee's estate or by any persons who shall have acquired the Option directly from the Optionee by bequest or inheritance, to the extent that, at the date of the Optionee's death, the Optionee's right to exercise such Option had accrued pursuant to the terms of the Option Agreement and had not previously been exercised.

(h) Rights as a Stockholder.

An Optionee or a transferee of an Optionee shall have no rights as a stockholder with respect to any Shares covered by his or her Option until the date of the issuance of a stock certificate for such Shares. No adjustment shall be made for dividends (ordinary or extraordinary, whether in cash, securities or other property) or distributions or other rights for which the record date is prior to the date such stock certificate is issued, except as provided in Section 11.

(i) Modification, Extension and Renewal of Options.

Subject to the terms and conditions and within the limitations of the Plan, the Committee may modify, extend or renew outstanding Options granted under the Plan, or accept

the exchange of outstanding Options (to the extent not theretofore exercised) for the granting of new Options (at the same or a different price) in substitution therefor. Notwithstanding the foregoing, however, no modification of an Option shall, without the consent of the Optionee, alter or impair any rights or obligations under any Option theretofore granted under the Plan.

(j) Stock Appreciation Rights.

In connection with the grant of any Option pursuant to the Plan, the Committee, in accordance with its Rules, may also grant a stock appreciation right pursuant to which the Optionee shall have the right to surrender all or part of such Option and to exercise the stock appreciation right (the “call”) and thereby to obtain payment of an amount equal to the difference obtained by subtracting the aggregate Exercise Price of the Shares subject to the Option (or the portion thereof) so surrendered from the Fair Market Value of such Shares on the date of such surrender. In the case of a stock appreciation right called after an event described in Section 7(e)(i) or (iv) above, “Fair Market Value” for purposes of this Subsection (j) shall be the greater of (A) the Fair Market Value of such Shares as of the date immediately prior to the event described in Section 7(e)(i) or (iv) above, or (B) the value of such Shares determined as of the date of the call in good faith by the Committee (as composed on the day preceeding the date of the event described in Section 7(e)(i) or (iv) above),

taking into consideration all relevant facts and circumstances. The call of such stock appreciation right shall be subject to such limitations (including, but not limited to, limitations as to time and amount) as the Committee shall deem appropriate. The payment may be made in shares of Common Stock (determined with reference to its Fair Market Value on the date of call), or in cash, or partly in cash and in shares of Common Stock, at the discretion of the Committee, provided that the Committee determines that such settlement is consistent with the purpose set forth in Section 1 hereof, and provided further, that if the stock appreciation right is called after an event described in Section 7(e)(i) or (iv), the payment shall be made in cash. For all purposes under the Plan, the terms “exercise” or “exercisable” shall be deemed to include the terms “call” or “callable” as such terms may apply to a stock appreciation right granted in conjunction with an Option, and in the event of the call of a stock appreciation right, the underlying Option will be deemed to have been exercised for all purposes under the Plan.

(k) Effect of Termination of Employment on Stock Appreciation Right.

In the event that an Optionee shall cease to be employed by the Corporation or its Subsidiaries for any reason, any stock appreciation right which may have been granted in conjunction with the grant of an Option shall expire on the date provided in the Option Agreement or in rules and regulations adopted by the Committee.

(l) Limitation of Annual Awards.

The aggregate Fair Market Value (determined as of the date the Option is granted) of the stock with respect to which any Incentive Stock Options are exercisable for the first time by an Optionee during any calendar year commencing after December 31, 1986 under this Plan and all other plans maintained by the Corporation, its parent or its Subsidiaries shall not exceed \$100,000.

(m) Other Provisions.

The Option Agreements authorized under the Plan shall contain such other provisions not inconsistent with the terms of the Plan, including, without limitation, restrictions upon the exercise of the Option, as the Committee shall deem advisable.

8. RESTRICTED STOCK.

(a) Grants.

Subject to the provisions of the Plan, the Committee shall have sole and complete authority to determine the persons to whom, and the time or times at which, grants of Restricted Stock will be made, the number of shares of Restricted Stock to be awarded, the price (if any) to be paid by the recipient of Restricted Stock, the time or times within which such Awards may be subject to forfeiture, and all other terms and conditions of the Awards. The Committee may condition the grant of Restricted Stock upon the attainment of specified performance goals or such other factors as the Committee may determine, in its sole discretion.

The terms of each Restricted Stock Award shall be set forth in a Restricted Stock Agreement between the Corporation and the Employee, which Agreement shall contain such provisions as the Committee determines to be necessary or appropriate to carry out the intent of the Plan with respect to such Award. Each Participant receiving a Restricted Stock Award shall be issued a stock certificate in respect of such shares of Restricted Stock. Such certificate shall be registered in the name of such Participant, and shall bear an appropriate legend referring to the terms, conditions, and restrictions applicable to such Award. The Committee shall require that stock certificates evidencing such shares be held by the Company until the restrictions thereon shall have lapsed, and that, as a condition of any Restricted Stock Award, the Participant shall have delivered to the Company a stock power, endorsed in blank, relating to the stock covered by such Award.

(b) Restrictions and Conditions .

The shares of Restricted Stock awarded pursuant to this Section 8 shall be subject to the following restrictions and conditions:

- (i) During a period set by the Committee commencing with the date of such Award (the “Restriction Period”), the Participant shall not

be permitted to sell, transfer, pledge, assign or encumber shares of Restricted Stock awarded under the Plan. Within these limits, the Committee, in its sole discretion, may provide for the lapse of such restrictions in installments and may accelerate or waive such restrictions in whole or in part, based on service, performance, a change of control of the Corporation and/or such other factors or criteria as the Committee may determine in its sole discretion.

(ii) Except as provided in this paragraph (ii) and paragraph (i) above, the Participant shall have, with respect to the shares of Restricted Stock, all of the rights of a shareholder of the Corporation, including the right to vote the shares, and the right to receive any cash dividends. The Committee, in its sole discretion, as determined at the time of Award, may provide that the payment of cash dividends shall or may be deferred and, if the Committee so determines, reinvested in additional Shares of Restricted Stock to the extent available under Section 6, or otherwise reinvested. Stock dividends issued with respect to Restricted Stock shall be treated as additional shares of Restricted Stock that are subject to the same restrictions and other terms and conditions that apply to the shares with respect to which such dividends are issued.

(iii) The Committee shall specify the conditions under which shares of Restricted Stock shall vest or be forfeited and such conditions shall be set forth in the Restricted Stock Agreement.

(iv) If and when the Restriction Period applicable to shares of Restricted Stock expires without a prior forfeiture of the Restricted Stock, certificates for an appropriate number of unrestricted Shares shall be delivered promptly to the Participant, and the certificates for the shares of Restricted Stock shall be cancelled.

9. OTHER SHARE-BASED AWARDS.

(a) Grants.

Other Awards of Shares and other Awards that are valued in whole or in part by reference to, or are otherwise based on, Shares ("Other Share-Based Awards"), may be granted either alone or in addition to or in conjunction with other Awards under this Plan. Awards under this Section 9 may include, but are not limited to, Stock Rights, stock appreciation rights not granted in connection with the grant of any Option pursuant to Section 7, the grant of Shares conditioned upon some specified event, the payment of cash based upon the performance of the Shares or the grant of securities convertible into Shares.

Subject to the provisions of the Plan, the Committee shall have sole and complete authority to determine the persons to whom and the time or times at which Other Share-Based Awards shall be made, the number of Shares or other securities, if any, to be granted pursuant to Other Share-Based Awards, and all other conditions of the Other Share-Based Awards. In making an Other Share-Based Award, the Committee may determine that the recipient of an Other Share-Based Award shall be entitled to receive, currently or on a deferred basis, interest or dividends or dividend equivalents with respect to the Shares or other securities covered by the Award, and the Committee may provide that such amounts (if any) shall be deemed to have been reinvested in additional Shares or otherwise reinvested. The terms of any Other Share-Based Award shall be set forth in an Other Share-Based Award Agreement between the Corporation and the Employee, which Agreement shall contain such provisions as the Committee determines to be necessary or appropriate to carry out the intent of the Plan with respect to such Award.

(b) Terms and Conditions.

In addition to the terms and conditions specified in the Other Share-Based Award Agreement, Other Share-Based Awards made pursuant to this Section 9 shall be subject to the following:

(i) Any Other Share-Based Award may not be sold, assigned, transferred, pledged or otherwise encumbered prior to the date on which the Shares are issued or the Award becomes payable, or, if later, the date on which any applicable restriction, performance or deferral period lapses.

(ii) The Other Share-Based Award Agreement shall contain provisions dealing with the disposition of such Award in the event of a termination of the Employee's employment prior to the exercise, realization or payment of such Award, and the Committee in its sole discretion, may provide for payment of the Award in the event of the Employee's retirement, Disability or death or the change of control of the Corporation, with such provisions to take account of the specific nature and purpose of the Award.

10. TERM OF PLAN.

Awards may be granted pursuant to the Plan until the termination of the Plan on December 31, 1998.

11. RECAPITALIZATION.

Subject to any required action by the stockholders, the number of Shares covered by this Plan as provided in Section 6, the number of Shares covered by or referenced in each outstanding Award, and the Exercise Price of each outstanding Option and any price required to be paid for

Restricted Stock or Other Share-Based Award shall be proportionately adjusted for any increase or decrease in the number of issued Shares resulting from a subdivision or consolidation of Shares, the payment of a stock dividend (but only of Common Stock) or any other increase or decrease in the number of such Shares effected without receipt of consideration by the Corporation or the declaration of a dividend payable in cash that has a material effect on the price of issued Shares.

Subject to any required action by the stockholders, if the Corporation shall be a party to any merger, consolidation or other reorganization, each outstanding Award shall pertain and apply to the securities to which a holder of the number of Shares subject to the Award would have been entitled.

In the event of a change in the Common Stock as presently constituted, which is limited to a change of all of its authorized shares with par value into the same number of shares with a different par value or without par value, the shares resulting from any such change shall be deemed to be the Common Stock within the meaning of the Plan.

To the extent that the foregoing adjustments relate to stock or securities of the Corporation, such adjustments shall be made by the Committee, whose determination in that respect shall be final, binding and conclusive, provided that each Incentive Stock Option granted pursuant to this Plan shall not be adjusted in a manner that causes the Option to fail to continue to qualify as an incentive stock option within the meaning of section 422 of the Code.

Except as hereinbefore expressly provided in this Section 11, a Participant shall have no rights by reason of any subdivision or consolidation of shares of stock of any class or the payment of any stock dividend or any other increase or decrease in the number of shares of stock of any class or by reason of any dissolution, liquidation, merger or consolidation or spin-off of assets or stock of another Corporation, and any issue by the Corporation of shares of stock of any class or securities convertible into shares of stock of any class, shall not affect, and no adjustment by reason thereof shall be made with respect to, the number or price of Shares subject to the Option.

The grant of an Option pursuant to the Plan shall not affect in any way the right or power of the Corporation to make adjustments, reclassifications, reorganizations or changes of its capital or business structure or to merge or consolidate or to dissolve, liquidate, sell or transfer all or any part of its business or assets.

12. SECURITIES LAW REQUIREMENTS AND LIMITATION OF RIGHTS.

(a) Securities Law. No Shares shall be issued pursuant to the Plan unless and until the Corporation has determined that: (i) it and the Participant have taken all actions required to register the Shares under the Securities Act of 1933 or perfect an exemption from the registration requirements thereof; (ii) any applicable listing requirement of any stock exchange on which the Common Stock is listed has been satisfied; and (iii) any other applicable provision of state or federal law has been satisfied.

(b) Employment Rights. Neither the Plan nor any Award granted under the Plan shall be deemed to give any individual a right to remain employed by the Corporation or a Subsidiary. The Corporation and its Subsidiaries reserve the right to terminate the employment of any employee at any time, with or without cause, subject only to a written employment contract (if any).

(c) Shareholders' Rights. A Participant shall have no dividend rights, voting rights or other rights as a shareholder with respect to any Shares covered by his or her Award prior to the issuance of a stock certificate for such Shares. No adjustment shall be made for cash dividends or other rights for which the record date is prior to the date when such certificate is issued.

(d) Creditors' Rights. A holder of an Other Share-Based Award shall have no rights other than those of a general creditor of the Corporation. An Other Share-Based Award shall represent an unfunded and unsecured obligation of the Corporation, subject to the terms and conditions of the applicable Other Share-Based Award Agreement.

13. AMENDMENT OF THE PLAN.

The Board may, insofar as permitted by law, from time to time, with respect to any Shares at the time not subject to Awards, suspend or discontinue the Plan or revise or amend it in any respect whatsoever except that, without approval of the holders of Common Stock of the Corporation, no such revision or amendment shall:

- (a) Increase the number of Shares subject to the Plan;
- (b) Change the designation in Section 5 of the Plan of the class of Employees eligible to receive Awards;
- (c) Decrease the price at which Incentive Stock Options may be granted;
- (d) Remove the administration of the Plan from the Committee;
- (e) Render any member of the Committee eligible to receive an Award under the Plan while serving thereon; or
- (f) Amend this Section 13 to defeat its purpose.

14. APPLICATION OF FUNDS.

The proceeds received by the Corporation from the sale of Common Stock pursuant to the exercise of an Option or the grant of Restricted Stock will be used for general corporate purposes.

15. NO OBLIGATION TO EXERCISE OPTION.

The granting of an Option shall impose no obligation upon the Optionee to exercise such Option.

16. APPROVAL OF STOCKHOLDERS.

This Plan and any amendments requiring shareholder approval pursuant to Section 13 hereof shall be subject to approval by affirmative vote of the shareholders in accordance with applicable law. Such vote shall be taken at the first annual meeting of stockholders of the Corporation following the adoption of the Plan or of any such amendments, or any adjournment thereof.

17. PAYMENT OF EXCISE TAXES.

If any payments or transfers to or for the benefit of the Participant is deemed an “excess parachute payment” as defined in Section 280G of the Internal Revenue Code of 1986 (the “Code”) subject to the excise tax imposed by Section 4999 of the Code, the Corporation shall pay to the Participant an additional amount such that the total amount of all such payments and benefits (including payments made pursuant to this Section) to the Participant

shall equal the total amount of all such payments and benefits to which the Participant would have been entitled (but for the Section) net of all applicable federal, state and local taxes except the excise tax. For purposes of this Section, the Participant shall be deemed to pay federal, state and local taxes at the highest marginal rate of taxation for the applicable calendar year. The amount of the payment to the Participant shall be estimated by the firm of independent certified public accountants serving as the outside auditor of the Corporation, as of the date of the applicable event as described in Section 7(e)(i)-(iv).

18. WITHHOLDING TAXES.

(a) General. To the extent required by applicable federal, state, local or foreign law, the recipient of any payment or distribution under the Plan shall make arrangements satisfactory to the Corporation for the satisfaction of any withholding tax obligations that arise by reason of such payment or distribution. The Corporation shall not be required to make such payment or distribution until such obligations are satisfied.

(b) Nonqualified Options. The Committee may permit an Optionee who exercises Nonqualified Stock Options to satisfy all or part of his or her withholding tax obligations by having the Company withhold a portion of the Shares that otherwise would be issued to him or her under such Nonqualified Stock Options. Such Shares shall be valued at

their Fair Market Value on the date when taxes otherwise would be withheld in cash. The payment of withholding taxes by surrendering Shares to the Corporation, if permitted by the Committee, shall be subject to such restrictions as the Committee may impose, including any restrictions required by rules of the Securities and Exchange Commission.

19. EXECUTION.

To record the amendment and restatement of the Plan to read as set forth herein effective as of December 2, 1999, the Corporation has caused its authorized officer to execute the same.

POTLATCH CORPORATION

By /s/ Betty R. Fleshman

Secretary

POTLATCH CORPORATION
1995 STOCK INCENTIVE PLAN
AS AMENDED AND RESTATED DECEMBER 2, 1999

1. PURPOSE .

This Potlatch Corporation 1995 Stock Incentive Plan is intended to provide incentive to employees and directors of Potlatch Corporation (the "Corporation") and its eligible subsidiaries, to encourage proprietary interest in the Corporation and to encourage employees and directors to remain in the service of the Corporation or its subsidiaries.

2. DEFINITIONS .

- (a) "Award " means any award of an option, Restricted Stock or an Other Share-Based Award under the Plan.
- (b) "Board " means the Board of Directors of the Corporation.
- (c) "Code " means the Internal Revenue Code of 1986, as amended.
- (d) "Committee " means the Committee appointed by the Board in accordance with Section 4.
- (e) "Common Stock " means the \$1 par value common stock of the Corporation.
- (f) "Corporation " means Potlatch Corporation, a Delaware corporation.
- (g) "Director " means a director of the Corporation.
- (h) "Disability " means the condition of an Employee who is unable to engage in any substantial gainful activity by reason

of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of at least 12 months.

(i) “ Employee ” means an individual (who may be an officer or a Director) employed by the Corporation or a Subsidiary (within the meaning of the Code section 3401 and the regulations thereunder).

(j) “ Exercise Price ” means the price per Share of Common Stock at which an option may be exercised.

(k) “ Fair Market Value ” of a Share as of a specified date means the closing price at which Shares are traded at the close of business on such date as reported in the New York Stock Exchange composite transactions published in the Western Edition of the Wall Street Journal, or if no trading of Shares is reported for that day, on the next preceding day on which trading was reported.

(l) “ Incentive Stock Option ” means an Option described in Code section 422 (b).

(m) “ Misconduct ” means that a Participant has engaged in unfair competition with the Corporation or a Subsidiary, induced any customer of the Corporation or a Subsidiary to breach any contract with the Corporation or a Subsidiary, made any unauthorized disclosure of any of the secrets or confidential information of the Corporation or a Subsidiary, committed an act of embezzlement, fraud or theft with respect to the property of the Corporation or a Subsidiary, or engaged in conduct which is not in good faith and which directly results in material loss, damage or injury to the business, reputation or employees of the Corporation or a Subsidiary.

(n) “ Nonqualified Stock Option ” means an Option not described in Code section 422 (b) or 423 (b).

(o) “ Option ” means a stock option granted pursuant to Section 7 or Section 10. “ Option Agreement ” means the agreement between the Corporation and the Participant which contains the terms and conditions pertaining to such Option.

(p) “ Other Share-Based Award ” means an Award granted pursuant to Section 9. “ Other Share-Based Award Agreement ” means the agreement between the Corporation and the recipient of an Other Share-Based Award which contains the terms and conditions pertaining to the Other Share-Based Award.

(q) “ Outside Director ” means a Director who is not an Employee.

(r) “ Participant ” means an Employee who has received an Award or an Outside Director who has received an Option.

(s) “ Plan ” means this Potlatch Corporation 1995 Stock Incentive Plan.

(t) “ Purchase Price ” means the Exercise Price times the number of whole Shares with respect to which an Option is exercised.

(u) “ Restricted Stock ” means Shares granted pursuant to Section 8. “ Restricted Stock Agreement ” means the agreement between the Corporation and the recipient of Restricted Stock which contains the terms, conditions and restrictions pertaining to the Restricted Stock.

(v) “ Share ” means one share of Common Stock, adjusted in accordance with Section 13 (if applicable).

(w) “ Stock Right ” means a bookkeeping entry representing a right to the equivalent of one Share.

(x) “ Subsidiary ” means any corporation in an unbroken chain of corporations beginning with the Corporation if each of the corporations other than the last corporation in the unbroken chain owns stock possessing 50% or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

3. EFFECTIVE DATE .

This Plan was adopted by the Board on December 7, 1995, to be effective immediately, subject to approval by the Corporation’s stockholders.

4. ADMINISTRATION .

The Plan shall be administered by a committee (the “Committee”) appointed by the Board, consisting of not less than two disinterested members. The term “disinterested members” as applied to Directors shall include only Directors who are not active Employees of the Corporation or of any of its Subsidiaries, who are not eligible to receive discretionary Awards under Sections 7, 8 and 9 of this Plan or under any other stock incentive plan of the Corporation and who have not received such discretionary Awards for at least one year preceding appointment as a member of the Committee. The Board may from time to time remove members from, or add members to, the Committee. Vacancies on the Committee shall be filled by the Board. The Board shall appoint one of the members of the Committee as Chairman.

If any member of the Committee does not qualify as an “outside director” for purposes of section 162 (m) of the Code, Awards under the Plan for the chief executive officer and the four most highly compensated officers of the Corporation (other than the chief executive officer) shall be administered by a subcommittee consisting of each Committee member who qualifies as an “outside director.” If fewer than two Committee members qualify as “outside directors,” the Board shall appoint one or more other members to such subcommittee who do qualify as “outside directors” so that it will at all times consist of at least two members who qualify as “outside directors” for purposes of section 162 (m) of the Code.

The Committee shall hold meetings at such times and places as it may determine. Acts of a majority of the Committee at which a quorum is present, or acts reduced to or approved in writing by a majority of the Committee, shall be the valid acts of the Committee. The Committee shall from time to time at its discretion make determinations with respect to Employees who shall be granted Awards, the number of Shares or Share equivalents to be subject to each Award, the vesting of Awards, the designation of Options as Incentive Stock Options or Nonqualified Stock Options and other conditions of Awards to Employees.

The interpretation and construction by the Committee of any provisions of the Plan or of any Award shall be final. No member of the Committee shall be liable for any action or determination made in good faith with respect to the Plan or any Award.

5. ELIGIBILITY.

Participants shall be such key Employees (who may be officers, whether or not they are Directors) of the Corporation or of its Subsidiaries as the Committee shall select, but subject to the terms and conditions set forth below. In addition, all Outside Directors shall be Participants solely for purposes of the nondiscretionary Awards described in Section 10.

(a) Ten Percent Stockholders.

An Employee who owns more than 10% of the total combined voting power of all classes of outstanding stock of the Corporation, its parent or any of its Subsidiaries is not eligible to receive an Incentive Stock Option pursuant to this Plan. For purposes of this Section 5 (a) the stock ownership of an Employee shall be determined pursuant to section 424 (d) of the Code.

(b) Number of Awards.

A Participant may receive more than one Award, including Awards of the same type, but only on the terms and subject to the restrictions set forth in the Plan. The maximum aggregate number of Shares or Share equivalents that may be subject to Awards to a Participant in any calendar year is 60,000 Shares.

6. STOCK.

The stock subject to Options, Restricted Stock, or Other Share-Based Awards granted under the Plan shall be Shares of the Corporation's authorized but unissued or reacquired Common Stock. The aggregate number of Options, Restricted Stock or Other

Share-Based Awards issued under this Plan shall not exceed 1,700,000 Shares. In the event that any outstanding Option under the Plan for any reason expires or is terminated or any Restricted Stock or Other Share-Based Award is forfeited, the Shares allocable to the unexercised portion of such Option or the forfeited Restricted Stock or Other Share-Based Award may again be subjected to Options, Restricted Stock or Other Share-Based Awards under the Plan, provided that under the terms of the Award the Participant received no benefits of ownership during the period the Award was outstanding. However, if one Award is granted in tandem with another, so that the exercise of one causes the other to expire, then the number of Shares subject to the expired Award shall not be restored to the pool available for Awards.

The limitations established by this Section 6 shall be subject to adjustment as provided in Section 13.

7. TERMS AND CONDITIONS OF EMPLOYEE OPTIONS.

Options granted to Employees pursuant to the Plan shall be evidenced by written Option Agreements in such form as the Committee shall determine, subject to the following terms and conditions:

(a) Number of Shares.

Each Option shall state the number of Shares to which it pertains and shall provide for the adjustment of such number in accordance with Section 13.

(b) Exercise Price.

Each Option shall state the Exercise Price, determined by the Committee, which shall not be less than the Fair Market Value of a Share on the date of grant.

(c) Medium and Time of Payment.

The Purchase Price shall be payable in full in United States dollars upon the exercise of the Option; provided that with the consent of the Committee and in accordance with its rules and regulations, the Purchase Price may be paid by the surrender of Shares in good form for transfer, owned by the person exercising the Option and having a Fair Market Value on the date of exercise equal to the Purchase Price, or in any combination of cash and Shares, so long as the total of the cash and the Fair Market Value of the Shares surrendered equals the Purchase Price. No Share shall be issued until full payment has been made.

(d) Term and Exercise of Options; Nontransferability of Options.

Each Option shall state the time or times when it becomes exercisable. No Option shall be exercisable after the expiration of 10 years from the date it is granted. During the lifetime of the Participant, the Option shall be exercisable only by the Participant and shall not be assignable or transferable. In the event of the Participant's death, no Option shall be transferable by the Participant other than by will or the laws of descent and distribution.

Subject to the foregoing, beginning six months after the date of grant the Participant shall have the right to exercise the Option (or to call the related stock appreciation right as described in Section 7 (i)) in whole or in part:

(i) Upon consummation of a reorganization, merger or consolidation involving the Corporation (a "Business Combination"), in each case, unless, following such Business Combination, (A) all or substantially all of the individuals and entities who were the beneficial owners, respectively, of the then outstanding shares of Common Stock (the "Outstanding Common Stock") and then outstanding voting securities of the Corporation entitled to vote generally in the election of directors (the "Outstanding Voting Securities") immediately prior to such Business Combination beneficially own, directly or indirectly, more than 50% of, respectively, the then outstanding shares of common stock and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors of the corporation resulting from such Business Combination (including, without limitation, a corporation which as a result of such transaction owns the Corporation either directly or through one or more subsidiaries), (B) no Person (as defined in subparagraph (iii) below) (excluding any corporation resulting from such Business Combination or any employee benefit plan (or related trust) sponsored or maintained by the Corporation or such other corporation resulting from such Business Combination) beneficially owns, directly or indirectly, 20% or more of, respectively, the then outstanding shares of common stock of the corporation resulting from such Business Combination or the combined voting power of the then outstanding voting securities of such corporation except to the extent that such

ownership is based on the beneficial ownership, directly or indirectly, of Outstanding Common Stock or Outstanding Voting Securities immediately prior to the Business Combination and (C) at least a majority of the members of the board of directors of the corporation resulting from such Business Combination were members of the Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination, provided, however, if the Corporation and the other party to the Business Combination agree that the transaction is to be treated as a pooling of interests for financial reporting purposes, and if the transaction in fact is so treated, then the right to exercise the Option (or to call the related stock appreciation right) shall not be accelerated upon consummation of the Business Combination to the extent that the Corporation's independent accountants and the other party's independent accountants separately determine in good faith that the acceleration would preclude the use of pooling of interests accounting; or

(ii) On the date that individuals who, as of December 2, 1999 constitute the Board (the "Incumbent Board") cease for any reason to constitute at least a majority of the Board; provided, however, that any individual becoming a Director subsequent to December 2, 1999 whose election, or nomination for election by the Corporation's stockholders, was approved by a vote of at least a majority of the Directors then comprising the Incumbent Board shall be considered as though such individual were a member of the Incumbent Board, but

excluding, for this purpose, any such individual whose initial assumption of office occurs as a result of an actual or threatened election contest with respect to the election or removal of Directors, an actual or threatened solicitation of proxies or consents or any other actual or threatened action by, or on behalf of any Person other than the Board; or

(iii) Upon the acquisition after December 2, 1999 by any individual, entity or group (withing the meaning of Section 13 (d) (3) or 14 (d) (2) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) (a “Person”) of beneficial ownership (within the meaning of Rule 13d-3 promulgated under the Exchange Act) of 20% or more of either (A) the then Outstanding Common Stock or (B) the combined voting power of the Outstanding Voting Securities; provided, however, that the following acquisitions shall not be deemed to be covered by this subsection (iii): (x) any acquisition of Outstanding Common Stock or Outstanding Voting Securities by the Corporation, (y) any acquisition of Outstanding Common Stock or Outstanding Voting Securities by any employee benefit plan (or related trust) sponsored or maintained by the Corporation or (z) any acquisition of Outstanding Common Stock or Outstanding Voting Securities by any corporation pursuant to a transaction which complies with clauses (A), (B) and (C) of subsection (i) of this Section 7 (d); or

(iv) Upon the consummation of the sale of all or substantially all of the assets of the Corporation or approval by the stockholders of the Corporation of a complete liquidation or dissolution of the Corporation.

(e) Termination of Employment Except Death.

In the event that a Participant who is an Employee ceases to be employed by the Corporation or its Subsidiaries for any reason other than death, such Participant shall have the right (subject to the limitations of Section 7 (d) above) to exercise the Option either:

(i) within three months after such termination of employment; or

(ii) (in the case of Early, Normal or Late Retirement under the Salaried Employees' Retirement Plan, or Disability), at any time before the end of the option period specified in the Option Agreement,

to the extent that, at the date of termination of employment, the Option had vested pursuant to the terms of the Option Agreement with respect to which such Option was granted and had not previously been exercised. However, if the employment of a Participant is terminated by the Corporation or a Subsidiary by reason of Misconduct, such Option shall cease to be exercisable at the time of the Participant's termination of employment. The Committee shall determine whether a Participant's employment is terminated by reason of Misconduct. In making such determination the Committee shall act fairly and shall give the Participant an opportunity to be heard and present evidence on his or her behalf.

For this purpose, the employment relationship will be treated as continuing while the Participant is on military leave, sick leave or other bona fide leave of absence (to be determined in the sole discretion of the Committee, in accordance with rules and regulations construing Code section 422 (a) (2)). Notwithstanding the foregoing, in the case of an Incentive Stock Option, employment shall not be deemed to continue beyond the 90th day after the Participant ceased active employment, unless the Participant's reemployment rights are guaranteed by statute or by contract.

(f) Death of Participant.

If a Participant who is an Employee dies while in the employ of the Corporation or a Subsidiary, the Option may be exercised at any time before the end of the option period as specified in the Option Agreement by the executors or administrators of the Participant's estate or by any person or persons who acquired the Option directly from the Participant by bequest or inheritance, to the extent that, at the date of the Participant's death, the Option had vested pursuant to the terms of the Option Agreement and had not previously been exercised.

(g) Rights as a Stockholder.

A Participant or a transferee of a Participant shall have no rights as a stockholder with respect to any Shares covered by his or her Option until the date of issuance of a stock certificate for such Shares. No adjustment shall be made for dividends, distributions or other rights for which the record date is prior to the date such stock certificate is issued, except as provided in Section 13.

(h) Modification, Extension and Renewal of Options.

Subject to the terms and conditions and within the limitations of the Plan, the Committee may modify, extend or renew outstanding Options granted to Employees under the Plan, or accept the exchange of outstanding Options (to the extent not previously exercised) for the granting of new Options (at the same or a different price). Notwithstanding the foregoing, however, no modification of an Option shall, without the consent of the Participant, alter or impair any rights or obligations under any Option previously granted under the Plan.

(i) Stock Appreciation Rights.

Each Option granted under the Plan shall include a stock appreciation right which may be exercised only following the applicable event described in Section 7 (d) (i) through (iv). Following any such event, the Participant shall have the right to surrender all or part of the Option and to exercise the stock appreciation right (the “call”) to obtain payment from the Corporation of an amount equal to the difference obtained by subtracting the aggregate Exercise Price of the Shares subject to the Option (or the portion of such Option) surrendered from the Fair Market Value of such Shares on the date of such surrender. In the case of a stock appreciation right called after an event described in Section 7 (d) (i) or (iv) above, “Fair Market Value” of purposes of this Subsection (i) shall be the greater of (A) the Fair Market Value of such

Shares as of the date immediately prior to the event described in Section 7 (d) (i) or (iv) above, or (B) the value of such Shares determined as of the date of the call in good faith by the Committee (as composed on the day preceding the date of the event described in Section 7 (d) (i) or (iv) above), taking into consideration all relevant facts and circumstances. The call of such stock appreciation right shall be subject to such limitations (including, but not limited to, limitations as to time and amount) as the Committee shall deem appropriate. The payment may be made in shares of Common Stock (determined with reference to its Fair Market Value on the date of call), or in cash, or partly in cash and in shares of Common Stock, at the discretion of the Committee, provided that the Committee determines that such settlement is consistent with the purpose set forth in Section 1, and provided further, that if the stock appreciation right is called after an event described in Section 7 (d) (i) or (iv), the payment shall be made in cash. For all purposes under the Plan, the terms “exercise” or “exercisable” shall be deemed to include the terms “call” or “callable” as such terms may apply to a stock appreciation right, and in the event of the call of a stock appreciation right, the underlying Option will be deemed to have been exercised for all purposes under the Plan.

(j) Limitation of Incentive Stock Option Awards.

The aggregate Fair Market Value (determined as of the date the Option is granted) of the stock with respect to which any Incentive Stock Options are exercisable for the first time by a Participant during any calendar year under this Plan and all other plans maintained by the Corporation, its parent or its Subsidiaries shall not exceed \$100,000.

(k) Other Provisions.

The Option Agreement shall contain such other provisions that are consistent with the terms of the Plan, including, without limitation, restrictions upon the exercise of the Option, as the Committee shall deem advisable.

8. RESTRICTED STOCK.

(a) Grants.

Subject to the provisions of the Plan, the Committee shall have sole and complete authority to determine the Employees to whom, and the time or times at which, grants of Restricted Stock will be made, the number of shares of Restricted Stock to be awarded, the price (if any) to be paid by the recipient of Restricted Stock, the time or times within which such Awards may be subject to forfeiture, and all other terms and conditions of the Awards. The Committee may condition the grant of Restricted Stock upon the attainment of specified performance goals or such other factors as the Committee may determine, in its sole discretion.

The terms of each Restricted Stock Award shall be set forth in a Restricted Stock Agreement between the Corporation and the Employee, which Agreement shall contain such provisions as the Committee determines to be necessary or appropriate to carry out the intent of the Plan. Each Participant receiving a Restricted Stock Award shall be issued a stock certificate in respect of such shares of Restricted Stock. Such certificate shall be registered in the name of such Participant, and shall bear an

appropriate legend referring to the terms, conditions, and restrictions applicable to such Award. The Committee shall require that stock certificates evidencing such shares be held by the Corporation until the restrictions lapse and that, as a condition of any Restricted Stock Award, the Participant shall deliver to the Corporation a stock power relating to the stock covered by such Award.

(b) Restrictions and Conditions.

The shares of Restricted Stock awarded pursuant to this Section 8 shall be subject to the following restrictions and conditions:

(i) During a period set by the Committee commencing with the date of such Award (the "Restriction Period"), the Participant shall not be permitted to sell, transfer, pledge, assign or encumber shares of Restricted Stock awarded under the Plan. Within these limits, the Committee, in its sole discretion, may provide for the lapse of such restrictions in installments and may accelerate or waive such restrictions in whole or in part, based on service, performance, a change of control of the Corporation or such other factors or criteria as the Committee may determine in its sole discretion.

(ii) Except as provided in this paragraph (ii) and paragraph (i) above, the Participant shall have, with respect to the shares of Restricted Stock, all of the rights of a stockholder of the Corporation, including the right to vote the shares and the right to receive any cash dividends. The Committee, in its sole discretion, as determined at the

time of Award, may provide that the payment of cash dividends shall or may be deferred and, if the Committee so determines, reinvested in additional Shares of Restricted Stock to the extent available under Section 6, or otherwise reinvested. Stock dividends issued with respect to Restricted Stock shall be treated as additional shares of Restricted Stock that are subject to the same restrictions and other terms and conditions that apply to the shares with respect to which such dividends are issued.

(iii) The Committee shall specify the conditions under which shares of Restricted Stock shall vest or be forfeited and such conditions shall be set forth in the Restricted Stock Agreement.

(iv) If and when the Restriction Period applicable to shares of Restricted Stock expires without a prior forfeiture of the Restricted Stock, certificates for an appropriate number of unrestricted Shares shall be delivered promptly to the Participant, and the certificates for the shares of Restricted Stock shall be canceled.

9. OTHER SHARE-BASED AWARDS .

(a) Grants .

Other Awards of Shares and other Awards that are valued in whole or in part by reference to, or are otherwise based on, Shares (“Other Share-Based Awards”), may be granted either alone or in addition to or in conjunction with other Awards under this Plan. Awards under this Section 9 may include (without limitation) Stock Rights, the grant of Shares conditioned upon some specified event, the payment of cash based upon the performance of the Shares or the grant of securities convertible into Shares.

Subject to the provisions of the Plan, the Committee shall have sole and complete authority to determine the Employees to whom and the time or times at which Other Share-Based Awards shall be made, the number of Shares or other securities, if any, to be granted pursuant to Other Share-Based Awards, and all other conditions of the Other Share-Based Awards. The Committee may condition the grant of an Other Share-Based Award upon the attainment of specified performance goals or such other factors as the Committee shall determine, in its sole discretion. In making an Other Share-Based Award, the Committee may determine that the recipient of an Other Share-Based Award shall be entitled to receive, currently or on a deferred basis, interest or dividends or dividend equivalents with respect to the Shares or other securities covered by the Award, and the Committee may provide that such amounts (if any) shall be deemed to have been reinvested in additional Shares or otherwise reinvested. The terms of any Other Share-Based Award shall be set forth in an Other Share-Based Award Agreement between the Corporation and the Employee, which Agreement shall contain such provisions as the Committee determines to be necessary or appropriate to carry out the intent of the Plan.

(b) Terms and Conditions.

In addition to the terms and conditions specified in the Other Share-Based Award Agreement, Other Share-Based Awards shall be subject to the following:

(i) Any Other Share-Based Award may not be sold, assigned, transferred, pledged or otherwise encumbered prior to the date on which the Shares are issued or the Award becomes payable, or, if later, the date on which any applicable restriction, performance or deferral period lapses.

(ii) The Other Share-Based Award Agreement shall contain provisions dealing with the disposition of such Award in the event of termination of the Employee's employment prior to the exercise, realization or payment of such Award, and the Committee in its sole discretion may provide for payment of the Award in the event of the Employee's retirement, Disability or death or the change of control of the Corporation, with such provisions to take account of the specific nature and purpose of the Award.

10. OPTION AWARDS TO OUTSIDE DIRECTORS.

(a) Initial Award Conditioned Upon Plan Approval.

Subject to the approval of the Plan by the stockholders of the Corporation, each individual who is an Outside Director on December 7, 1995, shall receive a Nonqualified Stock Option for 1,000 Shares as of such date.

(b) Award Upon Election.

Each Outside Director who is elected by the Board to fill a vacancy on the Board after the date on which Nonqualified Stock Options were last awarded pursuant to Section 10 (c) below, shall receive a Nonqualified Stock Option for 5,000 Shares on the date of the Board's regular meeting in December following his or her election; and if an Outside Director is so elected on the date of such meeting, he or she shall receive a Nonqualified Stock Option for 5,000 Shares on the date of such meeting.

(c) Annual Awards.

Each Outside Director shall receive a Nonqualified Stock Option for 2,500 Shares on the date of the Board's regular meeting in December of each year he or she serves as Outside Director, other than a year in which the Outside Director receives an award under Section 10 (b) above.

(d) Terms and Conditions of Options.

Each Nonqualified Stock Option granted pursuant to this Section 10 shall be subject to the following terms and conditions:

(i) The Exercise Price shall be the Fair Market Value of a Share on the date of grant.

(ii) The Option shall become exercisable in 50% increments on the first and second anniversaries of the date of grant, provided the Outside Director has continuously been an Outside Director from the date of grant until such time.

(iii) In the event the Outside Director terminates services as a Director for any reason other than death, the former Director shall have the right to exercise the Option either:

(A) within three months after such termination,

or

(B) (in the case of retirement after five years of service as an Outside Director) at any time before the end of the option period specified in the Option Agreement,

to the extent that, at the date of termination the Option had vested pursuant to (ii) above and had not previously been exercised. However, if the services of the Outside Director are terminated by the Board for cause in accordance with the Corporation's Restated Certificate of Incorporation, such Option shall cease to be exercisable at the time of the Outside Director's termination of services.

(iv) In the event the Outside Director's services terminate by reason of death, the Option may be exercised at any time before the end of the option period specified in the Option Agreement by the executors or administrators of the Director's estate or by any person or persons who shall have acquired the Option directly from the Director by bequest or inheritance, to the extent that, at the date of the Director's death, the Option had vested pursuant to (ii) above and had not previously been exercised.

Except as specifically set forth in (i) through (iv) above, each Nonqualified Stock Option granted pursuant to this Section 10 also shall be subject to all of the terms and conditions set forth in Section 7, other than Section 7 (h).

11. OTHER PAYMENTS IN SHARES.

Shares may be issued under this Plan to satisfy the payment of all or part of an award pursuant to the Potlatch Corporation Management Performance Award Plan. In addition, all or part of any Director's fees may be paid in Shares issued under this Plan. Any Shares issued pursuant to this Section 11 shall reduce the

number of Shares authorized for Options, Restricted Stock or Other Share-Based Awards under Section 6 but shall not be considered an Award for purposes of the maximum grant limitation in Section 5 (b).

12. TERM OF PLAN.

Awards may be granted and Shares may be issued pursuant to the Plan until the termination of the Plan on December 6, 2005.

13. RECAPITALIZATION.

Subject to any required action by the stockholders, the number of Shares covered by this Plan as provided in Section 6, the maximum grant limitation in Section 5 (b), the number of Shares covered by or referenced in each outstanding Award, the number of Options to be granted to Outside Directors under Sections 10 (a) through 10 (c) and the Exercise Price of each outstanding Option and any price required to be paid for Restricted Stock or Other Share-Based Award shall be proportionately adjusted for any increase or decrease in the number of issued Shares resulting from a subdivision or consolidation of Shares, the payment of a stock dividend (but only of Common Stock) or any other increase or decrease in the number of such Shares effected without receipt of consideration by the Corporation or the declaration of a dividend payable in cash that has a material effect on the price of issued Shares.

Subject to any required action by the stockholders, if the Corporation shall be a party to any merger, consolidation or other reorganization, each outstanding Award shall pertain and apply to the securities to which a holder of the number of Shares subject to the Award would have been entitled.

In the event of a change in the Common Stock as presently constituted, which is limited to a change of all of its authorized shares with par value into the same number of shares with a different par value or without par value, the shares resulting from any such change shall be deemed to be the Common Stock within the meaning of the Plan.

To the extent that the foregoing adjustments relate to stock or securities of the Corporation, such adjustments shall be made by the Committee, whose determination in that respect shall be final, binding and conclusive, provided that each Incentive Stock Option granted pursuant to this Plan shall not be adjusted in a manner that causes the Option to fail to continue to qualify as an incentive stock option within the meaning of section 422 of the Code.

Except as expressly provided in this Section 13, a Participant shall have no rights by reason of any subdivision or consolidation of shares of stock of any class or the payment of any stock dividend or any other increase or decrease in the number of shares of stock of any class or by reason of any dissolution, liquidation, merger or consolidation or spin-off of assets or stock of another corporation, and any issue by the Corporation of shares of stock of any class or securities convertible into shares of stock of any class, shall not affect the number or price of Shares subject to the Option.

The grant of an Option pursuant to the plan shall not affect in any way the right or power of the Corporation to make adjustments, reclassifications, reorganizations or changes of its capital or business structure or to merge or consolidate or to dissolve, liquidate, sell or transfer all or any part of its business assets.

14. SECURITIES LAW REQUIREMENTS AND LIMITATION OF RIGHTS.

(a) Securities Law.

No Shares shall be issued pursuant to the Plan unless and until the Corporation has determined that: (i) it and the Participant have taken all actions required to register the Shares under the Securities Act of 1933 or perfect an exemption from registration; (ii) any applicable listing requirement of any stock exchange on which the Common Stock is listed has been satisfied; and (iii) any other applicable provision of state or federal law has been satisfied.

(b) Employment Rights.

Neither the Plan nor any Award granted under the Plan shall be deemed to give any individual a right to remain employed by the Corporation or a Subsidiary or to remain a Director. The Corporation and its Subsidiaries reserve the right to terminate the employment of any employee at any time, with or without cause, subject only to a written employment contract (if any), and the Board reserves the right to terminate a Director's membership on the Board for cause in accordance with the Corporation's Restated Certificate of Incorporation.

(c) Stockholders' Rights.

A Participant shall have no dividend rights, voting rights or other rights as a stockholder with respect to any Shares covered by his or her Award prior to the issuance of a stock certificate for such Shares. No adjustment shall be made for cash dividends or other rights for which the record date is prior to the date when such certificate is issued.

(d) Creditors' Rights.

A holder of an Other Share-Based Award shall have no rights other than those of a general creditor of the Corporation. An Other Share-Based Award shall represent an unfunded and unsecured obligation of the Corporation, subject to the terms and conditions of the applicable Other Share-Based Award Agreement.

15. AMENDMENT OF THE PLAN.

The Board may suspend or discontinue the Plan or revise or amend it with respect to any Shares at the time not subject to Awards except that, without approval of the stockholders of the Corporation, no such revision or amendment shall:

- (a) Increase the number of Shares subject to the Plan;
- (b) Change the designation in Section 5 of the class of Employees eligible to receive Awards;
- (c) Decrease the price at which Incentive Stock Options may be granted;
- (d) Remove the administration of the Plan from the Committee;
- (e) Render any disinterested member of the Committee eligible to receive a discretionary Award under Sections 7, 8 and 9 while serving on the Committee;

(f) Change the provisions of Section 10 more than once in any six-month period, other than to comply with changes in the Code or the rules thereunder; or

(g) Amend this Section 15 to defeat its purpose.

16. APPLICATION OF FUNDS.

The proceeds received by the Corporation from the sale of the Common Stock pursuant to the exercise of an Option or the grant of Restricted Stock will be used for general corporate purposes.

17. NO OBLIGATION TO EXERCISE OPTION.

The granting of an Option shall impose no obligation upon the Participant to exercise such Option.

18. APPROVAL OF STOCKHOLDERS.

This Plan and any amendments requiring stockholder approval pursuant to Section 15 shall be subject to approval by affirmative vote of the stockholders in accordance with applicable law. Such vote shall be taken at the first annual meeting of stockholders of the Corporation following the adoption of the Plan or of any such amendments, or any adjournment of such meeting.

19. PAYMENT OF EXCISE TAXES.

If any payments or transfers to or for the benefit of the Participant is deemed an “excess parachute payment” as defined in Section 280G of the Internal Revenue Code of 1986 (the “Code”) subject to the excise tax imposed by Section 4999 of the Code, the Corporation shall pay to the Participant an additional amount such that the total amount of all such payments and

benefits (including payments made pursuant to this Section) to the Participant shall equal the total amount of all such payments and benefits to which the Participant would have been entitled (but for this Section) net of all applicable federal, state and local taxes except the excise tax. For purposes of this Section, the Participant shall be deemed to pay federal, state and local taxes at the highest marginal rate of taxation for the applicable calendar year. The amount of the payment to the Participant shall be estimated by the firm of independent certified public accountants serving as the outside auditor of the Corporation, as of the date of the applicable event as described in Section 7 (d) (i) - (iv).

20. WITHHOLDING TAXES.

(a) General.

To the extent required by applicable law, the recipient of any payment or distribution under the Plan shall make arrangements satisfactory to the Corporation for the satisfaction of any withholding tax obligations that arise by reason of such payment or distribution. The Corporation shall not be required to make such payment or distribution until such obligations are satisfied.

(b) Nonqualified Options.

The Committee may permit a Participant who exercises Nonqualified Stock Options to satisfy all or part of his or her withholding tax obligations by having the Corporation withhold a portion of the Shares that otherwise would be issued to him or her under such Nonqualified Stock Options. Such Shares shall be valued at their Fair Market Value on the date when taxes

otherwise would be withheld in cash. The payment of withholding taxes by surrendering Shares to the Corporation, if permitted by the Committee, shall be subject to such restrictions as the Committee may impose, including any restrictions required by rules of the Securities and Exchange Commission.

21. EXECUTION.

To record the amendment and restatement of the Plan effective December 2, 1999, the Corporation has caused its authorized officer to execute the same.

POTLATCH CORPORATION

By /s/ Betty R. Fleshman

Secretary

STOCK OPTION AGREEMENTPOTLATCH CORPORATION 1995 STOCK INCENTIVE PLAN

THIS AGREEMENT made and entered into the day specified in the attached addendum to this Agreement by and between POTLATCH CORPORATION, a Delaware corporation (the "Corporation") and the employee of the Corporation named in the attached addendum ("Employee"),

W I T N E S S E T H:

That to encourage stock ownership by employees of the Corporation and for other valuable consideration, the parties agree as follows:

1. Definitions.

- (a) "Agreement" means this stock option agreement.
- (b) "Board" means the Board of Directors of the Corporation.
- (c) "Change in Control" means an event or transaction described in Subparagraph (a), (b), (c) or (d) of Paragraph 3.
- (d) "Code" means the Internal Revenue Code of 1986, as amended.
- (e) "Common Stock" means the \$1 par value Common Stock of the Corporation.
- (f) "Committee" means the committee appointed by the Board to administer the Plan.
- (g) "Corporation" means Potlatch Corporation, a Delaware corporation.
- (h) "Date of Grant" means the date on which the Committee determined to grant this Option, as specified in Section 1 of the addendum to this Agreement.
- (i) "Disability" means the Employee is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of at least 12 months.

(j) “ Exercise Price ” means the price per Share designated in Section 2 of the addendum to this Agreement at which this Option may be exercised.

(k) “ Fair Market Value ” of a Share as of a specified date means the closing price at which Shares are traded at the close of business on such date as reported in the New York Stock Exchange composite transactions published in the Western Edition of The Wall Street Journal, or if no trading of Shares is reported for that day, on the next preceding day on which trading was reported.

(l) “ Incentive Stock Option ” means an Option described in Code section 422(b).

(m) “ Nonqualified Stock Option ” means an Option other than an Incentive Stock Option.

(n) “ Option ” means a stock option granted pursuant to the Plan.

(o) “ Option Period ” means the term of this Option as provided in Paragraph 3 of this Agreement.

(p) “ Partial Exercise ” means an exercise with respect to less than all of the vested but unexercised Shares subject to Option held by the person, exercising the Option.

(q) “ Plan ” means the Potlatch Corporation 1995 Stock Incentive Plan, pursuant to which the parties have entered into this Agreement.

(r) “ Purchase Price ” means the Exercise Price times the number of whole shares with respect to which this Option is exercised.

(s) “ Securities Act ” means the Securities Act of 1933, as amended.

(t) “ Share ” means one share of Common Stock, adjusted in accordance with Section 13 of the Plan.

(u) “ Subsidiary ” means any corporation in an unbroken chain of corporations beginning with the Corporation if each of the corporations other than the last corporation in the unbroken chain owns stock possessing 50% or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

2. The Corporation grants to Employee the option to purchase that number of shares of Common Stock specified in Section 3 of the addendum to this Agreement for the Exercise Price specified in Section 2 of the addendum to this Agreement, on the terms and conditions stated in this Agreement.

This Option has been granted pursuant to the Plan, a copy of the text of which Employee may obtain upon request to the Corporation.

3. Subject to the conditions stated in this Agreement, unless a different period is specified in Section 5 of the addendum to this Agreement, the period during which the option may be exercised (the "Vesting Schedule") shall be as follows:

<u>Number of Shares</u>	<u>Vesting Schedule*</u>
50% of the number of shares specified in Section 3 of the addendum	From one year from the Date of Grant to end of term for Option
50% of the number of shares specified in Section 3 of the addendum	From two years from the Date of Grant to end of term for Option

Beginning six months after the Date of Grant, Employee shall have the right to exercise the Option (or to call the related stock appreciation right as described in Paragraph 4), in whole or in part:

(a) Upon consummation of a reorganization, merger or consolidation involving the Corporation (a "Business Combination"), in each case, unless, following such Business Combination, (A) all or substantially all of the individuals and entities who were the beneficial owners, respectively, of the then outstanding shares of Common Stock (the "Outstanding Common Stock") and the then outstanding voting securities of the Corporation entitled to vote generally in the election of directors (the "Outstanding Voting Securities") immediately prior to such Business Combination beneficially own, directly or indirectly, more than 50% of, respectively, the then outstanding shares of common stock and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors of the corporation resulting from such Business Combination (including, without limitation, a corporation which as a result of such transaction owns the Corporation either directly or through one or more subsidiaries), (B) no

* See Paragraph 5 for further explanation of end of term for Option.

Person (as defined in subparagraph (c) below) (excluding any corporation resulting from such Business Combination or any employee benefit plan (or related trust) sponsored or maintained by the Corporation or such other corporation resulting from such Business Combination) beneficially owns, directly or indirectly, 20% or more of, respectively, the then outstanding shares of common stock of the corporation resulting from such Business Combination or the combined voting power of the then outstanding voting securities of such corporation except to the extent that such ownership is based on the beneficial ownership, directly or indirectly, of Outstanding Common Stock or Outstanding Voting Securities immediately prior to the Business Combination and (C) at least a majority of the members of the board of directors of the corporation resulting from such Business Combination were members of the Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination; provided, however, if the Corporation and the other party to the Business Combination agree that the transaction is to be treated as a pooling of interests for financial reporting purposes, and if the transaction in fact is so treated, then the right to exercise the Option (or to call the related stock appreciation right) shall not be accelerated upon consummation of the Business Combination to the extent that the Corporation's independent accountants and the other party's independent accountants separately determine in good faith that the acceleration would preclude the use of pooling of interests accounting; or

(b) On the date that individuals who, as of December 2, 1999 constitute the Board (the "Incumbent Board") cease for any reason to constitute at least a majority of the Board; provided, however, that any individual becoming a director subsequent to December 2, 1999 whose election, or nomination for election by the Corporation's stockholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board shall be considered as though such individual were a member of the Incumbent Board, but excluding, for this purpose, any such individual whose initial assumption of office occurs as a result of an actual or threatened election contest with respect to the election or removal of directors, an actual or threatened solicitation of proxies or consents or any other actual or threatened action by, or on behalf of any Person other than the Board; or

(c) Upon the acquisition after December 2, 1999 by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Securities Exchange Act

of 1934, as amended (the "Exchange Act")) (a "Person") of beneficial ownership (within the meaning of Rule 13d-3 promulgated under the Exchange Act) of 20% or more of either (A) the then Outstanding Common Stock or (B) the combined voting power of the Outstanding Voting Securities; provided, however, that the following acquisitions shall not be deemed to be covered by this subsection (c): (x) any acquisition of Outstanding Common Stock or Outstanding Voting Securities by the Corporation, (y) any acquisition of Outstanding Common Stock or Outstanding Voting Securities by any employee benefit plan (or related trust) sponsored or maintained by the Corporation or (z) any acquisition of Outstanding Common Stock or Outstanding Voting Securities by any corporation pursuant to a transaction which complies with clauses (A), (B) and (C) of subsection (a) of this Paragraph 3; or

(d) Upon the consummation of the sale of all or substantially all of the assets of the Corporation or approval by the stockholders of the Corporation of a complete liquidation or dissolution of the Corporation.

4. In the event of a Change in Control, this Option shall automatically include a stock appreciation right that may be called by the Employee. After a Change in Control, the employee may surrender all or part of this Option and exercise the stock appreciation right in lieu of exercising all or any part of this Option, provided that at least six months have elapsed from the Date of Grant and that the Fair Market Value of the Common Stock on the date of such exercise is higher than the Exercise Price specified in Section 2 of the addendum to this Agreement. The exercise of a stock appreciation right is referred to in this Paragraph 4 as the "call". Upon the call of a stock appreciation right, Employee shall be entitled to receive payment of an amount equal to the difference obtained by subtracting the aggregate option price of the shares subject to the Option (or the portion of such Option) from the Fair Market Value of such Shares on the date of such call. In the case of a stock appreciation right that is called after an event described in Paragraph 3(a) or 3(d), for purposes of measuring the value of the stock appreciation right, "Fair Market Value" shall be the greater of (a) the value of the consideration per share that the Employee would have received in connection with the transaction described in Paragraph 3(a) or 3(d) as a stockholder of the Corporation if he or she had exercised the Option immediately prior to the event described in Paragraph 3(a) or 3(d) or (b) the value determined as of the date of the call in good faith by the Committee (as composed on the day preceding the date of consummation of the transaction described in Paragraph 3(a) or 3(d)), taking into consideration all relevant facts and circumstances.

For all purposes under this Agreement (unless the context requires otherwise), the terms “exercise” or “exercisable” shall be deemed to include the terms “call” or “callable” as such terms may apply to a stock appreciation right, and in the event of the call of a stock appreciation right the underlying Option will be deemed to have been exercised for all purposes under the Plan.

Payment of a stock appreciation right shall be made as soon as reasonably practicable following receipt by the Corporation of the notice described in Paragraph 8. Unless otherwise required by the Plan, payment of the stock appreciation right shall be made in such form as may be permitted pursuant to the rules and regulations adopted from time to time by the Committee, as in effect on the date the stock appreciation right is called.

5. The term of this Option shall end and this Option shall not be exercisable after seven years from the Date of Grant if this Option is designated as an Incentive Stock Option in Section 4 of the addendum to this Agreement or 10 years from the Date of Grant if this Option is designated as a Nonqualified Stock Option in Section 4 of such addendum or, if earlier, upon the termination of Employee’s employment with the Corporation or its Subsidiaries, subject to the following provisions:

(a) If the termination of employment is caused by Employee’s death, this Option, to the extent that it was exercisable under Paragraph 3 of this Agreement at the date of death and had not previously been exercised, may be exercised at any time before the end of the Option Period as specified in the Option Agreement by Employee’s executors or administrators or by any person or persons who shall have acquired this Option directly from Employee by bequest or inheritance.

(b) If the termination of employment is caused by Disability or Early, Normal or Late Retirement under the Potlatch Corporation Salaried Employees’ Retirement Plan, this Option, to the extent it was exercisable under Paragraph 3 of this Agreement at the date of such termination and had not previously been exercised, may be exercised at any time before the end of the Option Period as specified in the Option Agreement.

(c) If the termination of employment is for any reason other than death, Disability, or Early, Normal or Late Retirement under the Potlatch Corporation Salaried Employees’ Retirement Plan, this Option, to the extent that it was exercisable under Paragraph 3 of this Agreement at the date of such termination and had not previously been exercised, may be exercised within three months after the

date of such termination; provided that in such case the right to call a stock appreciation right as described in Paragraph 4 shall terminate on the date Employee's employment terminates unless Employee requests and the Committee permits the call of the stock appreciation right within three months after the date of such termination. Notwithstanding the foregoing, if the termination of employment is by reason of Employee's misconduct, the option shall cease to be exercisable or callable at the time of such termination. As used in this Paragraph, "misconduct" means that Employee has engaged in unfair competition with the Corporation or a Subsidiary, induced any customer of the Corporation or a Subsidiary to breach any contract with the Corporation or a Subsidiary, made any unauthorized disclosure of any of the secrets or confidential information of the Corporation or a Subsidiary, committed an act of embezzlement, fraud or theft with respect to the property of the Corporation or a Subsidiary, or engaged in conduct which is not in good faith and which directly results in material loss, damage or injury to the business, reputation or employees of the Corporation or a Subsidiary. The Committee shall determine whether Employee's employment is terminated by reason of misconduct. In making such determination the Committee shall act fairly and shall give Employee an opportunity to be heard and present evidence on Employee's behalf.

6. The Corporation agrees that it will at all times during the Option Period reserve and keep available sufficient authorized but unissued or reacquired Common Stock to satisfy the requirements of this Agreement. The number of Shares reserved and the Exercise Price shall be proportionately adjusted for any increase or decrease in the number of issued and outstanding Shares by reason of stock dividends, stock splits, consolidations, recapitalizations, reorganizations or like events, as determined by the Committee pursuant to the Plan.

7. Subject to any required action by the stockholders, if the Corporation shall be a party to any merger, consolidation or other reorganization, this Option shall apply to the securities to which a holder of the number of Shares subject to this Option would have been entitled.

8. Employee, or Employee's representative, may exercise 20% or more of the portion of this Option that has become vested under Paragraph 3 of this Agreement by giving written notice to the Corporation at Spokane, Washington, attention of the Vice President, Employee Relations, specifying the election to exercise the Option, the number of Shares for which it is being exercised and the method of payment for the amount of the Purchase Price of the Shares for which this Option is exercised. Such payment shall be made:

(a) In United States dollars delivered at the time of exercise;

(b) Subject to the conditions stated in rules and regulations adopted by the Committee, by the surrender of Shares in good form for transfer, owned by the person exercising this Option and having an aggregate Fair Market Value on the date of exercise equal to the Purchase Price; or

(c) In any combination of Subparagraphs (a) and (b) above, if the total of the cash paid and the Fair Market Value of the Shares surrendered equals the Purchase Price of the Shares for which this Option is being exercised.

The notice shall be signed by the person or persons exercising this Option, and in the event this Option is being exercised by the representative of Employee, shall be accompanied by proof satisfactory to the Corporation of the right of the representative to exercise the Option. No Share shall be issued until full payment has been made. After receipt of full payment, the Corporation shall cause to be issued a certificate or certificates for the Shares for which this Option has been exercised, registered in the name of the person or persons exercising the Option (or in the name of such person or persons and another person as community property or as joint tenants), and cause such certificate or certificates to be delivered to or upon the order of such person or persons.

9. If any payments or transfers to or for the benefit of the Employee are deemed an “excess parachute payment” as defined in Section 280G of the Internal Revenue Code of 1986 (the “Code”) subject to the excise tax imposed by Section 4999 of the Code, the Corporation shall pay to the Employee an additional amount such that the total amount of all such payments and benefits (including payments made pursuant to this Section) to the Employee shall equal the total amount of all such payments and benefits to which the Employee would have been entitled (but for this Section) net of all applicable federal, state and local taxes except the excise tax. For purposes of this Section, the Employee shall be deemed to pay federal, state and local taxes at the highest marginal rate of taxation for the applicable calendar year. The amount of the payment to the Employee shall be estimated by the firm of independent certified public accountants serving as the outside auditor of the Corporation, as of the date of the applicable event as described in Paragraph 3(a) through 3(d).

10. In the event the Corporation determines that it is required to withhold state or federal income tax as a result of the exercise of this Option, as a condition to the exercise of the Option, Employee will make arrangements satisfactory to the Corporation to enable it to satisfy such withholding requirements.

11. Neither Employee nor Employee's representative shall have any rights as a stockholder with respect to any Shares subject to this Option until such Shares shall have been issued to Employee or Employee's representative.

12. Unless at the time Employee gives notice of the exercise of this Option, the Shares to be issued are registered under the Securities Act, the notice shall include a statement to the effect that all Shares for which this Option is being exercised are being purchased for investment, and without present intention of resale, and will not be sold without registration under the Securities Act or exemption from registration, and such other representations as the Committee may require. The Corporation may permit the sale or other disposition of any Shares acquired pursuant to any such representation if it is satisfied that such sale or other disposition would not contravene applicable state or federal securities laws. Unless the Corporation shall determine that, in compliance with the Securities Act or other applicable statute or regulation, it is necessary to register any of the Shares for which this Option has been exercised, and unless such registration, if required, has been completed, certificates to be issued upon the exercise of this Option shall contain the following legend:

“The Shares represented by this certificate have not been registered under the Securities Act of 1933 and may be offered, sold or transferred only if registered pursuant to the provisions of that Act or if an exemption from registration is available.”

13. Except as otherwise provided in this Agreement, this Option and the rights and privileges conferred by this Agreement shall not be transferred, assigned, pledged or hypothecated in any way (whether by operation of law or otherwise) and shall not be subject to sale under execution, attachment or similar process. Upon any attempt to transfer, assign, pledge, hypothecate or otherwise dispose of this Option, or of any right or privilege conferred by this Agreement, contrary to the provisions of this Paragraph, or upon any attempted sale under any execution, attachment or similar process upon the rights and privileges conferred by this Agreement, this Option and the rights and privileges conferred by this Agreement shall immediately become null and void.

14. Nothing in this Agreement shall be construed as giving Employee the right to be retained as an employee or as impairing the rights of the Corporation to terminate his or her employment at any time, with or without cause.

15. This Agreement shall be interpreted and construed in accordance with the laws of the State of Delaware without regard to choice of law principles.

ADDENDUM TO STOCK OPTION AGREEMENT
POTLATCH CORPORATION 1995 STOCK INCENTIVE PLAN

Name of Employee: _____

1. Date of Grant: _____
2. Exercise Price: \$ _____ per share, which is agreed to be one hundred percent (100%) of the Fair Market Value of the common stock subject to the Option on the Date of Grant.
3. The number of Shares subject to this Stock Option Agreement is _____, subject to adjustment as provided in Section 13 of the Plan and Paragraph 6 of this Stock Option Agreement.
4. This Option is: A Nonqualified Stock Option
5. The Vesting Schedule for this Option is: The schedule specified in Paragraph 3 of the Stock Option Agreement, except that no exercise or call will be permitted for a fractional Share.

The document entitled Stock Option Agreement - Potlatch Corporation 1995 Stock Incentive Plan is incorporated by this reference into this addendum.

IN WITNESS WHEREOF, the Corporation has caused this addendum to the Stock Option Agreement to be executed on its behalf by its duly authorized representative, and the Employee has executed the same on the date indicated below.

POTLATCH CORPORATION

Date: _____

By _____
Vice President Employee Relations

Date: _____

By _____
Employee

STOCK OPTION AGREEMENTPOTLATCH CORPORATION 1995 STOCK INCENTIVE PLAN

THIS AGREEMENT made and entered into the day specified in the attached addendum to this Agreement by and between POTLATCH CORPORATION, a Delaware corporation (the "Corporation") and the outside director of the Corporation named in the attached addendum ("Outside Director"),

W I T N E S S E T H:

That to encourage stock ownership by directors of the Corporation and for other valuable consideration, the parties agree as follows:

1. Definitions.

- (a) "Agreement" means this stock option agreement.
- (b) "Board" means the Board of Directors of the Corporation.
- (c) "Change in Control" means an event or transaction described in Subparagraph (a), (b), (c) or (d) of Paragraph 3.
- (d) "Code" means the Internal Revenue Code of 1986, as amended.
- (e) "Common Stock" means the \$1 par value Common Stock of the Corporation.
- (f) "Committee" means the committee appointed by the Board to administer the Plan. If Outside Director is a member of such Committee, Outside Director shall not participate in any actions and determinations of the Committee with respect to this Agreement.
- (g) "Corporation" means Potlatch Corporation, a Delaware corporation.
- (h) "Date of Grant" means the date specified in Section 1 of the addendum to this Agreement.
- (i) "Exercise Price" means the price per Share designated in Section 2 of the addendum to this Agreement at which this Option may be exercised.

(j) “ Fair Market Value ” of a Share as of a specified date means the closing price at which Shares are traded at the close of business on such date as reported in the New York Stock Exchange composite transactions published in the Western Edition of The Wall Street Journal, or if no trading of Shares is reported for that day, on the next preceding day on which trading was reported.

(k) “ Nonqualified Stock Option ” means an Option other than an incentive stock option described in Code section 422(b).

(l) “ Option ” means a stock option granted pursuant to the Plan.

(m) “ Option Period ” means the term of this Option as provided in Paragraph 3 of this Agreement.

(n) “ Partial Exercise ” means an exercise with respect to less than all of the vested but unexercised Shares subject to Option held by the person exercising the Option.

(o) “ Plan ” means the Potlatch Corporation 1995 Stock Incentive Plan, pursuant to which the parties have entered into this Agreement.

(p) “ Purchase Price ” means the Exercise Price times the number of whole shares with respect to which this Option is exercised.

(q) “ Securities Act ” means the Securities Act of 1933, as amended.

(r) “ Share ” means one share of Common Stock, adjusted in accordance with Section 13 of the Plan.

(s) “ Subsidiary ” means any corporation in an unbroken chain of corporations beginning with the Corporation if each of the corporations other than the last corporation in the unbroken chain owns stock possessing 50% or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

2. The Corporation grants to Outside Director the option to purchase that number of shares of Common Stock specified in Section 3 of the addendum to this Agreement for the Exercise Price specified in Section 2 of the addendum to this Agreement, on the terms and conditions stated in this Agreement.

This Option has been granted pursuant to the Plan, a copy of the text of which Outside Director may obtain upon request to the Corporation.

3. Subject to the conditions stated in this Agreement, the period during which the Option may be exercised (the “Vesting Schedule”) shall be as follows:

<u>Number of Shares</u>	<u>Vesting Schedule*</u>
50% of the number of shares specified in Section 3 of the addendum	From one year from the Date of Grant to end of term for Option
50% of the number of shares specified in Section 3 of the addendum	From two years from the Date of Grant to end of term for Option

Beginning six months after the Date of Grant, Outside Director shall have the right to exercise the Option (or to call the related stock appreciation right as described in Paragraph 4), in whole or in part:

(a) Upon consummation of a reorganization, merger or consolidation involving the Corporation (a “Business Combination”), in each case, unless, following such Business Combination, (A) all or substantially all of the individuals and entities who were the beneficial owners, respectively, of the then outstanding shares of Common Stock (the “Outstanding Common Stock”) and the then outstanding voting securities of the Corporation entitled to vote generally in the election of directors (the “Outstanding Voting Securities”) immediately prior to such Business Combination beneficially own, directly or indirectly, more than 50% of, respectively, the then outstanding shares of common stock and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors of the corporation resulting from such Business Combination (including, without limitation, a corporation which as a result of such transaction owns the Corporation either directly or through one or more subsidiaries), (B) no Person (as defined in subparagraph (c) below) (excluding any corporation resulting from such Business Combination or any employee benefit plan (or related trust) sponsored or maintained by the Corporation or such other corporation resulting from such Business Combination) beneficially owns, directly or indirectly, 20% or more of, respectively, the

* See Paragraph 5 for further explanation of end of term for Option.

then outstanding shares of common stock of the corporation resulting from such Business Combination or the combined voting power of the then outstanding voting securities of such corporation except to the extent that such ownership is based on the beneficial ownership, directly or indirectly, of Outstanding Common Stock or Outstanding Voting Securities immediately prior to the Business Combination and (C) at least a majority of the members of the board of directors of the corporation resulting from such Business Combination were members of the Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination provided, however, if the Corporation and the other party to the Business Combination agree that the transaction is to be treated as a pooling of interests for financial reporting purposes, and if the transaction in fact is so treated, then the right to exercise the Option (or to call the related stock appreciation right) shall not be accelerated upon consummation of the Business Combination to the extent that the Corporation's independent accountants and the other party's independent accountants separately determine in good faith that the acceleration would preclude the use of pooling of interests accounting; or

(b) On the date that individuals who, as of December 2, 1999 constitute the Board (the "Incumbent Board") cease for any reason to constitute at least a majority of the Board; provided, however, that any individual becoming a director subsequent to December 2, 1999 whose election, or nomination for election by the Corporation's stockholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board shall be considered as though such individual were a member of the Incumbent Board, but excluding, for this purpose, any such individual whose initial assumption of office occurs as a result of an actual or threatened election contest with respect to the election or removal of directors, an actual or threatened solicitation of proxies or consents or any other actual or threatened action by, or on behalf of any Person other than the Board; or

(c) Upon the acquisition after December 2, 1999 by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Securities Exchange Act of 1934, as amended (the "Exchange Act")) (a "Person") of beneficial ownership (within the meaning of Rule 13d-3 promulgated under the Exchange Act) of 20% or more of either (A) the then Outstanding Common Stock or (B) the combined voting power of the Outstanding Voting Securities; provided, however, that the following acquisitions shall not be deemed

to be covered by this subsection (c): (x) any acquisition of Outstanding Common Stock or Outstanding Voting Securities by the Corporation, (y) any acquisition of Outstanding Common Stock or Outstanding Voting Securities by any employee benefit plan (or related trust) sponsored or maintained by the Corporation or (z) any acquisition of Outstanding Common Stock or Outstanding Voting Securities by any corporation pursuant to a transaction which complies with clauses (A), (B) and (C) of subsection (a) of this Paragraph 3; or

(d) Upon the consummation of the sale of all or substantially all of the assets of the Corporation or approval by the stockholders of the Corporation of a complete liquidation or dissolution of the Corporation.

4. In the event of a Change in Control, this Option shall automatically include a stock appreciation right that may be called by the Outside Director. After a Change in Control event, the Outside Director may surrender all or part of this Option and exercise the stock appreciation right in lieu of exercising all or any part of this Option, provided that at least six months have elapsed from the Date of Grant and that the Fair Market Value of the Common Stock on the date of such exercise is higher than the Exercise Price specified in Section 2 of the addendum to this Agreement. The exercise of a stock appreciation right is referred to in this Paragraph 4 as the "call". Upon the call of a stock appreciation right, Outside Director shall be entitled to receive payment of an amount equal to the difference obtained by subtracting the aggregate option price of the shares subject to the Option (or the portion of such Option) from the Fair Market Value of such Shares on the date of such call. In the case of a stock appreciation right that is called after an event described in Paragraph 3(a) or 3(d), for purposes of measuring the value of the stock appreciation right, "Fair Market Value" shall be the greater of (a) the value of the consideration per share that the Outside Director would have received in connection with the transaction described in Paragraph 3(a) or 3(d) as a stockholder of the Corporation if he or she had exercised the Option immediately prior to the event described in Paragraph 3(a) or 3(d) or (b) the value determined as of the date of the call in good faith by the Committee (as composed on the day preceding the date of consummation of the transaction described in Paragraph 3(a) or 3(d)), taking into consideration all relevant facts and circumstances.

For all purposes under this Agreement (unless the context requires otherwise), the terms "exercise" or "exercisable" shall be deemed to include the terms "call" or "callable" as such terms may apply to a stock appreciation right, and in the event of the call of a stock appreciation right the underlying Option will be deemed to have been exercised for all purposes under the Plan.

Payment of a stock appreciation right shall be made as soon as reasonably practicable following receipt by the Corporation of the notice described in Paragraph 8. Unless otherwise required by the Plan, payment of the stock appreciation right shall be made in such form as may be permitted pursuant to the rules and regulations adopted from time to time by the Committee, as in effect on the date the stock appreciation right is called.

5. The term of this Option shall end and this Option shall not be exercisable after 10 years from the Date of Grant or, if earlier, upon the termination of Outside Director's services as a director of the Corporation subject to the following provisions:

(a) If the termination of services is caused by Outside Director's death, this Option, to the extent that it was exercisable under Paragraph 3 of this Agreement at the date of death and had not previously been exercised, may be exercised at any time before the end of the Option Period as specified in the Option Agreement by Outside Director's executors or administrators or by any person or persons who shall have acquired this Option directly from Outside Director by bequest or inheritance.

(b) If the termination of services is caused by retirement after five years of service as an Outside Director of the Corporation, this Option, to the extent it was exercisable under Paragraph 3 of this Agreement at the date of such termination and had not previously been exercised, may be exercised at any time before the end of the Option Period as specified in the Option Agreement.

(c) If the termination of services is for any reason other than death or retirement, this Option, to the extent that it was exercisable under Paragraph 3 of this Agreement at the date of such termination and had not previously been exercised, may be exercised within three months after the date of such termination; provided that in such case the right to call a stock appreciation right as described in Paragraph 4 shall terminate on the date Outside Director's services terminate unless Outside Director requests and the Committee permits the call of the stock appreciation right within three months after the date of such termination. Notwithstanding the foregoing, if the termination of services is for cause, the option shall cease to be exercisable or callable at the time of such termination. The Board shall determine whether Outside Director's services are terminated for cause in accordance with the Corporation's Restated Certificate of Incorporation.

6. The Corporation agrees that it will at all times during the Option Period reserve and keep available sufficient authorized but unissued or reacquired Common Stock to satisfy the requirements of this Agreement. The number of Shares reserved and the Exercise Price shall be proportionately adjusted for any increase or decrease in the number of issued and outstanding Shares by reason of stock dividends, stock splits, consolidations, recapitalizations, reorganizations or like events, as determined by the Committee pursuant to the Plan.

7. Subject to any required action by the stockholders, if the Corporation shall be a party to any merger, consolidation or other reorganization, this Option shall apply to the securities to which a holder of the number of Shares subject to this Option would have been entitled.

8. Outside Director, or Outside Director's representative, may exercise this Option by giving written notice to the Corporation at Spokane, Washington, attention of the Secretary, specifying the election to exercise the Option, the number of Shares for which it is being exercised and the method of payment for the amount of the Purchase Price of the Shares for which this Option is exercised. Such payment shall be made:

(a) In United States dollars delivered at the time of exercise;

(b) Subject to the conditions stated in rules and regulations adopted by the Committee, by the surrender of Shares in good form for transfer, owned by the person exercising this Option and having an aggregate Fair Market Value on the date of exercise equal to the Purchase Price; or

(c) In any combination of Subparagraphs (a) and (b) above, if the total of the cash paid and the Fair Market Value of the Shares surrendered equals the Purchase Price of the Shares for which this Option is being exercised.

The notice shall be signed by the person or persons exercising this Option, and in the event this Option is being exercised by the representative of Outside Director, shall be accompanied by proof satisfactory to the Corporation of the right of the representative to exercise the Option. No Share shall be issued until full payment has been made. After receipt of full payment, the Corporation shall cause to be issued a certificate or certificates for the Shares for which this Option has been

exercised, registered in the name of the person or persons exercising the Option (or in the name of such person or persons and another person as community property or as joint tenants), and cause such certificate or certificates to be delivered to or upon the order of such person or persons.

9. In the event the Corporation determines that it is required to withhold state or federal income tax as a result of the exercise of this Option, as a condition to the exercise of the Option, Outside Director will make arrangements satisfactory to the Corporation to enable it to satisfy such withholding requirements.

10. Neither Outside Director nor Outside Director's representative shall have any rights as a stockholder with respect to any Shares subject to this Option until such Shares shall have been issued to Outside Director or Outside Director's representative.

11. Unless at the time Outside Director gives notice of the exercise of this Option, the Shares to be issued are registered under the Securities Act, the notice shall include a statement to the effect that all Shares for which this Option is being exercised are being purchased for investment, and without present intention of resale, and will not be sold without registration under the Securities Act or exemption from registration, and such other representations as the Committee may require. The Corporation may permit the sale or other disposition of any Shares acquired pursuant to any such representation if it is satisfied that such sale or other disposition would not contravene applicable state or federal securities laws. Unless the Corporation shall determine that, in compliance with the Securities Act or other applicable statute or regulation, it is necessary to register any of the Shares for which this Option has been exercised, and unless such registration, if required, has been completed, certificates to be issued upon the exercise of this Option shall contain the following legend:

"The Shares represented by this certificate have not been registered under the Securities Act of 1933 and may be offered, sold or transferred only if registered pursuant to the provisions of that Act or if an exemption from registration is available."

12. Except as otherwise provided in this Agreement, this Option and the rights and privileges conferred by this Agreement shall not be transferred, assigned, pledged or hypothecated in any way (whether by operation of law or otherwise) and shall not be subject to sale under execution, attachment or similar process. Upon any attempt to transfer, assign, pledge,

hypothecate or otherwise dispose of this Option, or of any right or privilege conferred by this Agreement, contrary to the provisions of this Paragraph, or upon any attempted sale under any execution, attachment or similar process upon the rights and privileges conferred by this Agreement, this Option and the rights and privileges conferred by this Agreement shall immediately become null and void.

13. Nothing in this Agreement shall be construed as giving Outside Director the right to be retained as a director of the Corporation.

14. This Agreement shall be interpreted and construed in accordance with the laws of the State of Delaware without regard to choice of law principles.

ADDENDUM TO STOCK OPTION AGREEMENT

POTLATCH CORPORATION 1995 STOCK INCENTIVE PLAN

Name of Outside Director: _____

1. Date of Grant: _____
2. Exercise Price: \$ _____ per share, which is agreed to be one hundred percent (100%) of the Fair Market Value of the common stock subject to the Option on the Date of Grant.
3. The number of Shares subject to this Option is (check one):
_____ 5,000 Shares (Director Election)
_____ 2,500 Shares (Annual Grant)

This number is subject to adjustment as provided in Section 13 of the Plan and Paragraph 6 of this stock option agreement.

The document entitled Stock Option Agreement - Potlatch Corporation 1995 Stock Incentive Plan is incorporated by this reference into this addendum.

IN WITNESS WHEREOF, the Corporation has caused this addendum to the stock option agreement to be executed on its behalf by its duly authorized representative and the Outside Director has executed the same on the date indicated below.

POTLATCH CORPORATION

Date:

By _____

Secretary

Date:

By _____

Outside Director

CONSENT

October 15, 2004

Potlatch Corporation
601 West Riverside Avenue, Suite 1100
Spokane, WA 99201
Attn: Gerald L. Zuehlke, Vice President and Chief Financial Officer

Re: Credit Agreement dated as of June 29, 2004 among Potlatch Corporation, a Delaware corporation, as Borrower, the Guarantors from time to time party thereto, the Lenders from time to time party thereto, and Bank of America, N.A., as Administrative Agent (as amended, modified, restated and supplemented from time to time, the "Credit Agreement").

Ladies and Gentlemen:

Reference is hereby made to the above-referenced Credit Agreement. Capitalized terms used herein without definition shall have the meanings ascribed to such terms in the Credit Agreement.

You have notified the Administrative Agent that the Borrower intends to implement (i) a special dividend with respect to the Borrower's common stock in the amount of \$2.50 per share for an aggregate dividend of approximately \$80,000,000 which shall be paid during fiscal year 2004 (the "Special Dividend") and (ii) a stock repurchase program pursuant to which the Borrower will repurchase up to approximately 1,600,000 shares of its common stock for an aggregate purchase price of no more than \$90,000,000 over the remaining term of Credit Agreement (the "Stock Repurchases"). Each of the Special Dividend and the Stock Repurchase constitute Restricted Payments that are not permitted pursuant to Section 7.07 of the Credit Agreement. Accordingly, you have requested that, notwithstanding the terms of Section 7.07 of the Credit Agreement, the Required Lenders and the Administrative Agent consent to the Special Dividend and the Stock Repurchases.

The Administrative Agent and the Required Lenders hereby consent to the Special Dividend and the Stock Repurchases so long as (i) no Default or Event of Default exists at the time of such payment or would result therefrom, (ii) such payments are permitted pursuant to the terms of the Senior Subordinated Note Indenture, to the extent the Senior Subordinated Notes are still outstanding at the time of such payments and (iii) in the case of the Special Dividend, the aggregate amount of all cash dividends paid by the Borrower with respect to its common stock during fiscal year 2004 shall not exceed \$100,000,000.

Except to the extent specifically provided to the contrary in this letter, all terms and conditions of the Credit Agreement shall remain in full force and effect, without modification or limitation. This consent shall not operate as a consent to any other action or inaction by the Borrower or any of the Guarantors, or as a waiver of any right, power, or remedy of any Lender or the Administrative Agent under, or any provision contained in, the Credit Agreement except as specifically provided herein. This consent may be executed in two or more counterparts, each of which shall be deemed an original, and all of which taken together shall be deemed to constitute one and the same instrument. This letter shall constitute a Loan Document.

ADMINISTRATIVE AGENT :

Very truly yours,

BANK OF AMERICA, N.A.,
In its capacity as Administrative Agent

By: _____
Name: _____
Title: _____

LENDERS :

BANK OF AMERICA, N.A.,
Individually in its capacity as Issuing Lender, Swing Line
Lender and as a Lender

By: _____
Name: _____
Title: _____

U.S. BANK, NATIONAL ASSOCIATION

By: _____
Name: _____
Title: _____

WACHOVIA BANK, NATIONAL ASSOCIATION

By: _____
Name: _____
Title: _____

THE BANK OF NOVA SCOTIA

By: _____
Name: _____
Title: _____

[Lender Signatures Continue]

COOPERATIEVE CENTRALE RAIFFEISEN-
BOERENLEENBANK B.A. "RABOBANK
INTERNATIONAL" NEW YORK BRANCH

By: _____
Name: _____
Title: _____

By: _____
Name: _____
Title: _____

WELLS FARGO BANK, N.A.

By: _____
Name: _____
Title: _____

COBANK ACB

By: _____
Name: _____
Title: _____

STERLING SAVINGS BANK

By: _____
Name: _____
Title: _____

THE BANK OF TOKYO-MITSUBISHI, LTD.
SEATTLE BRANCH

By: _____
Name: _____
Title: _____

[Lender Signatures Continue]

NORTHWEST FARM CREDIT SERVICES, FLCA

By: _____

Name: _____

Title: _____

CAPITAL FARM CREDIT

By: _____

Name: _____

Title: _____

The terms of the foregoing Consent
dated as of October 15, 2004 are hereby
acknowledged and agreed to:

BORROWER :

POTLATCH CORPORATION

By: _____
Name: _____
Title: _____

Potlatch Corporation
Computation of Ratio of Earnings to Fixed Charges
(in thousands)

	2004	2003	2002	2001	2000
Earnings (loss) from continuing operations before taxes on income	25,297	(12,990)	(67,575)	(71,471)	(78,308)
Add:					
Interest expense	45,863	48,172	59,882	77,853	59,438
Rental expense factor (1)	5,446	4,582	3,688	2,846	2,956
Discount and loan expense amortization	3,075	3,757	2,688	3,755	508
Earnings available for fixed charges	79,681	43,521	(1,317)	12,983	(15,406)
Fixed charges:					
Interest expense	45,863	48,172	59,882	77,853	59,438
Capitalized interest	383	2,907	300	1,032	3,964
Rental expense factor (1)	5,446	4,582	3,688	2,846	2,956
Discount and loan expense amortization	3,075	3,757	2,688	3,755	508
Total fixed charges	54,767	59,418	66,558	85,486	66,866
Ratio of earnings to fixed charges	1.5	0.7	0.0	0.2	(0.2)

(1) “Rental expense factor” is the portion of rental expense estimated to be representative of the interest factor within rental expense.

The dollar amount of deficiency in earnings available for fixed charges for a one-to-one ratio for the years 2003, 2002, 2001 and 2000 are \$15,897, \$67,875, \$72,503 and \$82,272, respectively.

Certain amounts for 2000-2003 have been reclassified to conform to the 2004 presentation.

Potlatch Corporation
Subsidiaries

The following subsidiaries are included in the company's consolidated financial statements.

<u>Name</u>	<u>State in Which Organized</u>	<u>Percentage of Securities Owned</u>
Prescott & Northwestern Railroad Co.	Arkansas	100
St. Maries River Railroad Co.	Idaho	100
Warren & Saline River Railroad Co.	Arkansas	100
NaturNorth Technologies, LLC	Delaware	58

All unnamed subsidiaries, when considered in the aggregate as a single subsidiary, would not constitute a significant subsidiary. No separate financial statements are filed for any subsidiary.

Consent of Independent Registered Public Accounting Firm

The Board of Directors
Potlatch Corporation:

We consent to the incorporation by reference in the registration statements (Nos. 333-17145, 333-42808, 33-54515, 333-28079, 333-74956, 333-12017, and 333-42806) on Form S-8 of Potlatch Corporation of our reports dated February 18, 2005, with respect to the consolidated balance sheets of Potlatch Corporation and consolidated subsidiaries as of December 31, 2004 and 2003, and the related consolidated statements of operations and comprehensive income, cash flows and stockholders' equity for each of the years in the three-year period ended December 31, 2004, and the related financial statement schedule, management's assessment of the effectiveness of internal control over financial reporting as of December 31, 2004 and the effectiveness of internal control over financial reporting as of December 31, 2004, which reports appear in the December 31, 2004 annual report on Form 10-K of Potlatch Corporation.

/s/ KPMG LLP

Portland, Oregon
February 18, 2005

POWER OF ATTORNEY

I, the undersigned, appoint Malcolm A. Ryerse or, in his absence or inability to act, L. Pendleton Siegel or Gerald L. Zuehlke, my attorney-in-fact for me and in my name, place and stead to execute for me on my behalf in my capacity as a Director of Potlatch Corporation, the Annual Report on Form 10-K of Potlatch Corporation for the fiscal year ended December 31, 2004, to be filed with the Securities and Exchange Commission under the Securities Exchange Act of 1934, and any and all amendments thereto, hereby ratifying, approving and confirming all that any such attorney-in-fact may do by virtue of this Power of Attorney.

IN WITNESS WHEREOF, I have executed this Power of Attorney as of February 23, 2005.

/s/ Boh A. Dickey

DIRECTOR

POWER OF ATTORNEY

I, the undersigned, appoint Malcolm A. Ryerse or, in his absence or inability to act, L. Pendleton Siegel or Gerald L. Zuehlke, my attorney-in-fact for me and in my name, place and stead to execute for me on my behalf in my capacity as a Director of Potlatch Corporation, the Annual Report on Form 10-K of Potlatch Corporation for the fiscal year ended December 31, 2004, to be filed with the Securities and Exchange Commission under the Securities Exchange Act of 1934, and any and all amendments thereto, hereby ratifying, approving and confirming all that any such attorney-in-fact may do by virtue of this Power of Attorney.

IN WITNESS WHEREOF, I have executed this Power of Attorney as of February 23, 2005.

/s/ William L. Driscoll

DIRECTOR

POWER OF ATTORNEY

I, the undersigned, appoint Malcolm A. Ryerse or, in his absence or inability to act, L. Pendleton Siegel or Gerald L. Zuehlke, my attorney-in-fact for me and in my name, place and stead to execute for me on my behalf in my capacity as a Director of Potlatch Corporation, the Annual Report on Form 10-K of Potlatch Corporation for the fiscal year ended December 31, 2004, to be filed with the Securities and Exchange Commission under the Securities Exchange Act of 1934, and any and all amendments thereto, hereby ratifying, approving and confirming all that any such attorney-in-fact may do by virtue of this Power of Attorney.

IN WITNESS WHEREOF, I have executed this Power of Attorney as of February 23, 2005.

/s/ Ruth Ann M. Gillis

DIRECTOR

POWER OF ATTORNEY

I, the undersigned, appoint Malcolm A. Ryerse or, in his absence or inability to act, L. Pendleton Siegel or Gerald L. Zuehlke, my attorney-in-fact for me and in my name, place and stead to execute for me on my behalf in my capacity as a Director of Potlatch Corporation, the Annual Report on Form 10-K of Potlatch Corporation for the fiscal year ended December 31, 2004, to be filed with the Securities and Exchange Commission under the Securities Exchange Act of 1934, and any and all amendments thereto, hereby ratifying, approving and confirming all that any such attorney-in-fact may do by virtue of this Power of Attorney.

IN WITNESS WHEREOF, I have executed this Power of Attorney as of February 23, 2005.

/s/ Jerome C. Knoll

DIRECTOR

POWER OF ATTORNEY

I, the undersigned, appoint Malcolm A. Ryerse or, in his absence or inability to act, L. Pendleton Siegel or Gerald L. Zuehlke, my attorney-in-fact for me and in my name, place and stead to execute for me on my behalf in my capacity as a Director of Potlatch Corporation, the Annual Report on Form 10-K of Potlatch Corporation for the fiscal year ended December 31, 2004, to be filed with the Securities and Exchange Commission under the Securities Exchange Act of 1934, and any and all amendments thereto, hereby ratifying, approving and confirming all that any such attorney-in-fact may do by virtue of this Power of Attorney.

IN WITNESS WHEREOF, I have executed this Power of Attorney as of February 23, 2005.

/s/ Lawrence S. Peiros

DIRECTOR

POWER OF ATTORNEY

I, the undersigned, appoint Malcolm A. Ryerse or, in his absence or inability to act, L. Pendleton Siegel or Gerald L. Zuehlke, my attorney-in-fact for me and in my name, place and stead to execute for me on my behalf in my capacity as a Director of Potlatch Corporation, the Annual Report on Form 10-K of Potlatch Corporation for the fiscal year ended December 31, 2004, to be filed with the Securities and Exchange Commission under the Securities Exchange Act of 1934, and any and all amendments thereto, hereby ratifying, approving and confirming all that any such attorney-in-fact may do by virtue of this Power of Attorney.

IN WITNESS WHEREOF, I have executed this Power of Attorney as of February 23, 2005.

/s/ Gregory L. Quesnel

DIRECTOR

POWER OF ATTORNEY

I, the undersigned, appoint Malcolm A. Ryerse or, in his absence or inability to act, L. Pendleton Siegel or Gerald L. Zuehlke, my attorney-in-fact for me and in my name, place and stead to execute for me on my behalf in my capacity as a Director of Potlatch Corporation, the Annual Report on Form 10-K of Potlatch Corporation for the fiscal year ended December 31, 2004, to be filed with the Securities and Exchange Commission under the Securities Exchange Act of 1934, and any and all amendments thereto, hereby ratifying, approving and confirming all that any such attorney-in-fact may do by virtue of this Power of Attorney.

IN WITNESS WHEREOF, I have executed this Power of Attorney as of February 23, 2005.

/s/ Michael T. Riordan

DIRECTOR

POWER OF ATTORNEY

I, the undersigned, appoint Malcolm A. Ryerse or, in his absence or inability to act, L. Pendleton Siegel or Gerald L. Zuehlke, my attorney-in-fact for me and in my name, place and stead to execute for me on my behalf in my capacity as a Director of Potlatch Corporation, the Annual Report on Form 10-K of Potlatch Corporation for the fiscal year ended December 31, 2004, to be filed with the Securities and Exchange Commission under the Securities Exchange Act of 1934, and any and all amendments thereto, hereby ratifying, approving and confirming all that any such attorney-in-fact may do by virtue of this Power of Attorney.

IN WITNESS WHEREOF, I have executed this Power of Attorney as of February 23, 2005.

/s/ Judith M. Runstad

DIRECTOR

POWER OF ATTORNEY

I, the undersigned, appoint Malcolm A. Ryerse or, in his absence or inability to act, L. Pendleton Siegel or Gerald L. Zuehlke, my attorney-in-fact for me and in my name, place and stead to execute for me on my behalf in my capacity as a Director of Potlatch Corporation, the Annual Report on Form 10-K of Potlatch Corporation for the fiscal year ended December 31, 2004, to be filed with the Securities and Exchange Commission under the Securities Exchange Act of 1934, and any and all amendments thereto, hereby ratifying, approving and confirming all that any such attorney-in-fact may do by virtue of this Power of Attorney.

IN WITNESS WHEREOF, I have executed this Power of Attorney as of February 23, 2005.

/s/ William T. Weyerhaeuser

DIRECTOR

CERTIFICATIONS

I, L. Pendleton Siegel, certify that:

1. I have reviewed this report on Form 10-K of Potlatch Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonable likely to materially affect, the registrant's internal control over financial reporting, and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 25, 2005

/s/ L. Pendleton Siegel

L. Pendleton Siegel
Chief Executive Officer

CERTIFICATIONS

I, Gerald L. Zuehlke, certify that:

1. I have reviewed this report on Form 10-K of Potlatch Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 25, 2005

/s/ Gerald L. Zuehlke

Gerald L. Zuehlke
Chief Financial Officer

STATEMENT OF CHIEF EXECUTIVE OFFICER UNDER 18 U.S.C. § 1350

I, L. Pendleton Siegel, Chairman of the Board and Chief Executive Officer of Potlatch Corporation (the "Company"), certify pursuant to section 1350 of Chapter 63 of Title 18 of the United States Code that, to my knowledge,:

- (1) the Annual Report of the Company on Form 10-K for the period ending December 31, 2004, as filed with the Securities and Exchange Commission on February 25, 2005, (the "Report"), fully complies with the requirements of section 13(a) of the Securities Exchange Act of 1934, and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ L. Pendleton Siegel

L. Pendleton Siegel
Chairman of the Board and
Chief Executive Officer
February 25, 2005

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

STATEMENT OF CHIEF FINANCIAL OFFICER UNDER 18 U.S.C. § 1350

I, Gerald L. Zuehlke, Vice President, Finance and Chief Financial Officer of Potlatch Corporation (the "Company"), certify pursuant to section 1350 of Chapter 63 of Title 18 of the United States Code that, to my knowledge,:

- (1) the Annual Report of the Company on Form 10-K for the period ending December 31, 2004, as filed with the Securities and Exchange Commission on February 25, 2005, (the "Report"), fully complies with the requirements of section 13(a) of the Securities Exchange Act of 1934, and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Gerald L. Zuehlke

Gerald L. Zuehlke
Vice President, Finance
and Chief Financial Officer
February 25, 2005

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.